

# **Office of the Under Secretary of Defense (Comptroller) (OUSD(C))**

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## **Documentation for Audits of Property, Plant, and Equipment**

### **Student Guide**



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<b>Course Title</b>	<b>Documentation for Audits of Property, Plant, and Equipment</b>	
<b>Course Identification</b>	Course Code: OSD-PP&E	Course Type: F
<b>Level and Type</b>	Introductory Functional Course	
<b>Course Length</b>	8 hours	8 CPE credit hours
<b>Field of Study</b>	Accounting and Audit, Government Accounting and Reporting – Specialized.	
<b>Course Description</b>	<p>The Documentation for Audits of Property, Plant, and Equipment (PP&amp;E) course, Version 1.0, is an eight-hour, introductory functional course designed to provide the knowledge needed to produce the evidential matter to support a clean audit of PP&amp;E operations in the DoD. Students will learn the key legislative and regulatory requirements needed to optimize operational effectiveness while managing evidential matter required to substantiate the financial statements. Students will also learn how virtually every DoD job, whether financial or non-financial, contributes to specific components of the financial statements. Additionally, students will be provided with useful tools for satisfying independent audit requirements.</p>	
<b>Learning Objectives</b>	<p>Upon completion of this course, the student will be able to:</p> <ul style="list-style-type: none"> <li>• define requirements, regulations, statutes, and thresholds for each component for PP&amp;E audits</li> <li>• understand the principal documentation of PP&amp;E</li> <li>• explain how to manage the evidential matter to support assertion</li> </ul>	
<b>Presentation Mode</b>	The primary methods of instruction are conference, questions and discussion, and a final examination.	
<b>Who Should Attend</b>	The audience for this course is civilian and military personnel of various grades and ranks. It consists of both financial and non-financial personnel who desire to improve their operations while satisfying Congressional and regulatory audit requirements.	



**Prerequisites**      There are no prerequisites for this course.

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## Course Agenda

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8:00-8:10	Course Introduction
8:10-8:50	Lesson 1 – Identifying Critical Components of Property
9:00-9:50	Lesson 1 – Identifying Critical Components of Property (cont.)
10:00-10:35	Lesson 1 – Identifying Critical Components of Property (cont.)
10:35-10:50	Lesson 2 – Documenting Transactions for Components of PP&E
11:00-11:50	Lesson 2 – Documenting Transactions for Components of PP&E (cont.)
12:00-1:00	Lunch
1:00-1:30	Lesson 2 – Documenting Transactions for Components of PP&E (cont.)
1:30-1:50	Lesson 3 – Managing Evidential Matter to Support Assertions
2:00-2:50	Lesson 3 – Managing Evidential Matter to Support Assertions (cont.)
3:00-3:30	Lesson 3 – Managing Evidential Matter to Support Assertions (cont.)
3:30-3:40	End-of-Course Review
3:40-4:30	Final Examination and Final Examination Review
4:30-4:50	Course Critique

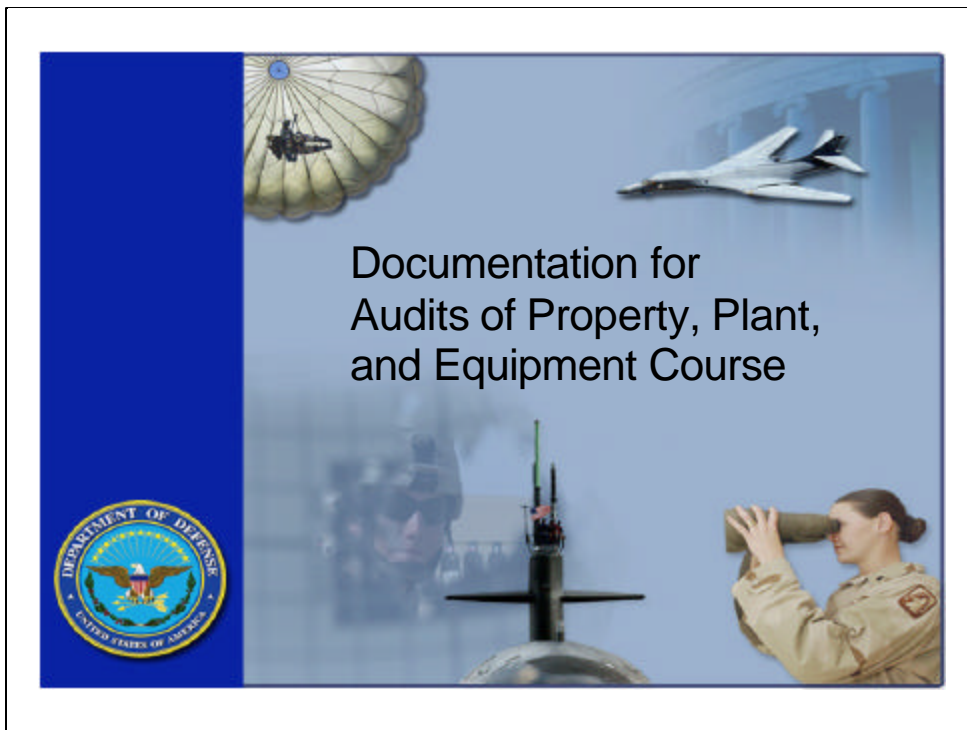
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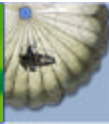
Good morning and welcome to the Documentation for Audits of Property, Plant, and Equipment course.

Deficiencies in audits related to PP&E have been highlighted by the Government Accountability Office (GAO) and the DoD Inspector General, as well as audits conducted by the military department. Additionally, the Office of Management and Budget (OMB) indicated that PP&E is a problem preventing both the DoD and the federal government from achieving an unqualified audit opinion on their annually audited financial statements.

To achieve an unqualified audit opinion in this area, the Department must properly record all PP&E in compliant subsidiary property management systems that then pass the information to the appropriate accounting systems.

But, before we get into more in depth information, lets discuss some important points.












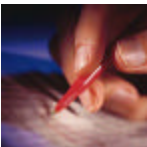
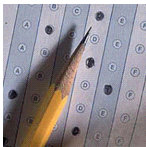
## Course Introduction



- **Meet your instructor**
- **Housekeeping issues**
- **Other**

Now let's talk about a few general housekeeping topics.



			
 <p>Starting Time</p>	 <p>Coffee Breaks</p>	 <p>Restrooms</p>	 <p>Cell Phones</p>
 <p>Lunch Break</p>	 <p>Phone Calls</p>	 <p>Nondisclosure</p>	 <p>Exercise/Exam</p>
<hr/> <p>Version 1.0                      Documentation for Audits of PP&amp;E                      3</p>			

Restrooms are located at \_\_\_\_\_, and break facilities, coffee, and snacks are located at \_\_\_\_\_. Drinks and snacks are not allowed in the classroom.



Please silence all pagers and cell phones, and refrain from their use while in the classroom. If you must stay in contact, please leave the room to answer a silent page. Telephones for your use are located at \_\_\_\_\_.

During this discussion, you will be provided with examples of financial transactions and other proprietary information either from the instruction or from your classmates. You must assume that this information is not for use by the general public, nor is it to be published or disseminated to third parties.



The format for this class is conference/lecture and will include questions and discussion. There are no practice exercises, but there is a final examination. You may use any materials provided in the course or discussion to complete this examination.






















Let's take a look at these materials.



## Icon Definitions

Course/Lesson Flow		Course Topics	
 <b>Logistics</b>	 <b>Key Point</b>	 <b>Steps</b>	 <b>Goal</b>
 <b>Starting Time</b>	 <b>Definition</b>	 <b>Quote</b>	 <b>Tools</b>
 <b>Objectives</b>	 <b>Background</b>	 <b>Detail</b>	 <b>Information</b>
 <b>Summary</b>	 <b>Law/ Standard</b>	 <b>Example</b>	 <b>Best Practice</b>
 <b>Questions</b>	 <b>Report</b>	 <b>Issues/ Resolutions</b>	
 <b>Exercise/ Exam</b>			
 <b>References</b>			

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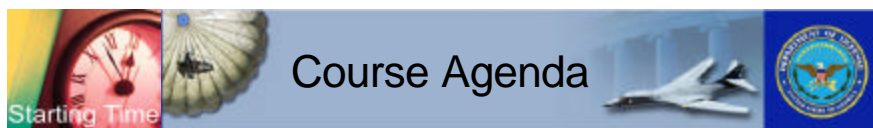
Notice that each page is formatted with a header. The left corner of each header contains an icon that provides a visual key to the contents of the page. For example, this page displays the Logistics icon.

The main icons describe course and lesson objectives and introduce key topics. Additional icons within each topic represent definitions, background information, and issues and resolutions. Best Practice and Lessons Learned icons will show examples of successful practices implemented by the government or industry. At the conclusion of each lesson, icons will represent the lesson summary, questions and answers, final examination, and references for more information.

Please feel free to take notes on your student materials, and to write down any questions that you may have that we may not have had time to address during the discussion of a particular topic. Your questions are very important to us, but we may not have the answer or sufficient time available in the classroom and may have to go to an outside source for an answer.

Now let's examine the course agenda.





Time	Title
8:00 - 8:10	Introduction
8:10 - 10:35	Lesson 1, Identifying Critical Components of Property
10:35 - 11:50	Lesson 2, Documenting Transactions for Components of PP&E
12:00 - 1:00	Lunch
1:00 - 1:30	Lesson 2, Documenting Transactions for Components of PP&E (cont.)
1:30 - 3:30	Lesson 3, Managing Evidential Matter to Support Assertions
3:30 - 4:30	Final Examination and Final Examination Review
4:30 - 4:50	Course Critique

This is our road map for the day.

Class starts promptly at 8:00 a.m., and will break for ten minutes each hour.

Lunch is scheduled from 12:00 to 1:00, and the course ends at 5:00 p.m.

In this course, there are three lessons, an end-of-course review, and a final examination. Lesson 1 will be completed and Lesson 2 will be started before lunch. Lessons 2 and 3 will conclude after lunch. Finally, you will complete a course critique and the instructor will distribute the course completion certificates.

Let's discuss the purpose and objectives.





## Course Overview

**This course is designed to focus on documentation. It identifies critical components of property and then examines documentation that must be available for review or audit. Finally, the course explains how to manage the evidential matter used to support assertions.**

**This is important because it examines what is needed to assist you in obtaining an unqualified audit opinion.**

This course is designed to help you in proving your stewardship (or accountability) of national resources is compliant with policy and procedures. So how do you “prove” your stewardship? You need to know what steps are required of each member of your organization to be able to successfully complete a financial statement audit. This audit is the end of a long process that starts with the documentation of PP&E.

Let’s look at the course objectives.





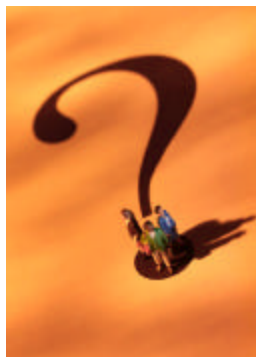
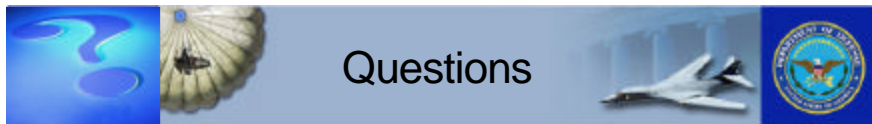
**Upon successful completion of this course, you will be able to:**

- **define applicable regulations and statutes**
- **understand the principal documentation**
- **explain reporting requirements.**

This course will convey the skills necessary for you to help the Department achieve a clean audit opinion. Upon successful completion, you will be able to understand requirements and produce evidentiary matter in support of reporting requirements leading to successful completion of the assertion process on related audits.

Now let's examine the course agenda.



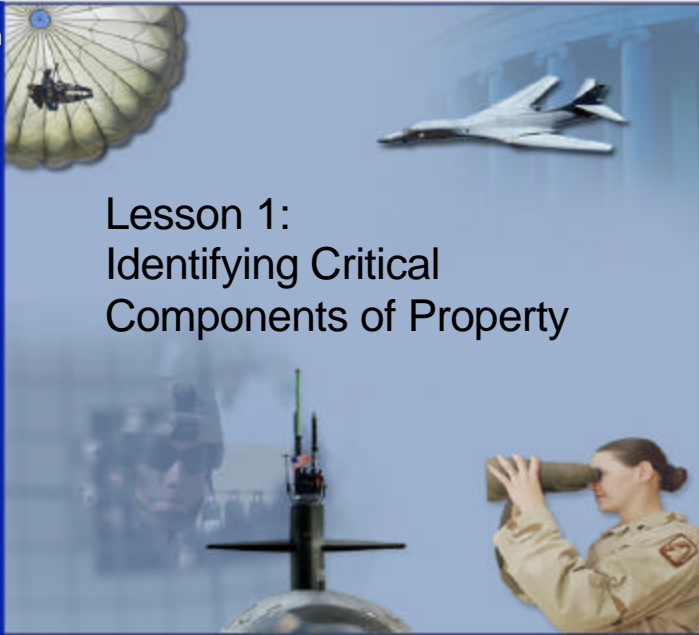




Documentation  
for Audits of  
Property,  
Plant, and  
Equipment



## Lesson 1: Identifying Critical Components of Property



In Lesson 1, we will examine the critical components of property from several points of view, all with the goal of helping you become better prepared for an audit of property, plant, and equipment within your organizations.





**Upon successful completion of this lesson, you will be able to:**

- **identify regulations for software and equipment compliance requirements**
- **explain how to manage risks associated with PP&E, and the importance of good internal controls.**

Lesson 1 examines the various requirements, regulations, statutes, and thresholds for each component of PP&E audits. This lesson takes a closer look at how to manage risks associated with PP&E and the importance of good internal controls.





## Lesson Topics



**This lesson contains the following topics:**

- **PP&E Requirements**
- **DoD Financial Management Systems**
- **Preventing Inconsistencies**
- **Statutory Requirements**

Here are the topics we will cover in this lesson starting with the PP&E Requirements. We will discuss the Federal Accounting Standards Advisory Board and its role in the development of federal accounting standards. We will also discuss specific requirements in the DoDFMR, Financial Audit Manual, and OMB Circulars, among others.

In the topic DoD Financial Management Systems, we discuss the federal mandates that financial management systems must comply with and we look at the Department's long standing financial management problems as highlighted by various audits.

Our discussion on preventing inconsistencies is highlighted by a look at what you can do to help. Often inconsistencies are deemed someone else's problem or too big for me to affect. We will look at those things that you can do to make a difference toward achieving an unqualified audit opinion on the Department's consolidated financial statements.

As we move on to look at the Statutory Requirements, our discussion is centered on the laws that drive our activities and we also take a quick look at some of the current legal issues surrounding the audit of financial statements.





## Lesson Topics (cont.)



**This lesson contains the following topics:**

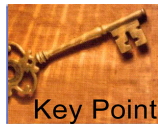
- **Management Responsibilities**
- **Audit Coordination**
- **Audit Trails**
- **Internal Controls.**

As we continue, the topic Management Responsibilities examines the various higher level responsibilities and their implementation. The topic also examines specific management actions that will assist you at every level of the operation as you work toward compliance with laws and regulations.

During our discussion on Audit Coordination, we will review the numerous tentacles of audit preparation that reach into every organization. The goal of this topic is to assist in your understanding of the importance of establishing effective communication channels with all potential sources of audit documentation. Your early work in this area can set the tone for an easier audit and relates directly to the next topic, Audit Trails. In this topic, we take a close look at what constitutes an audit trail and the importance of you being able to put your hands on documentation. Areas such as reconciling equipment feeder systems to the general ledger and the importance of documentation accompanying the transfer of items are discussed.

And finally, the last topic we discuss in this lesson is Internal Controls. Here we talk about applicable laws and guidance, including Office of Management and Budget (OMB) circulars. One of the more important discussions is on GAO's five standards for internal control. So let's get started with the PP&E requirements.





## PP&E Requirements



**Supporting documentation is required for the three categories of PP&E:**

- **General PP&E**

- Not for sale
- Cost \$100K or more
- Useful life at least two years



- **Heritage Assets**

- Historical or natural significance
- Cultural, educational, or artistic
- Significant architectural characteristics



- **Stewardship Land**

- Not acquired for or with General PP&E
- Includes all land from the public domain

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Documentation for Audits of PP&E

L1-5

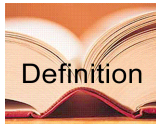
Let's begin our examination of the Documentation for Audits of PP&E by acknowledging the definition of the categories of PP&E. General PP&E are those tangible assets, whether from General or Working Capital Funds, that have an estimated useful life of two or more year; are not for sale in the ordinary course of business; are constructed or bought for use by the entity; and have an initial acquisition cost, book value, or, when applicable, an estimated fair market value of \$100,000.00 or more. The acquisition costs and other costs required to make the asset operable as well as the cost of modifications and upgrades are also capitalized if they meet the threshold.

Heritage Assets are government-owned assets that have one or more of the following characteristics: a historical or natural significance, a cultural, educational, or artistic importance, or significant architectural characteristics. The costs of acquiring Heritage Assets and Stewardship Land are expensed in the period incurred. Some Heritage Assets are used both to remind us of our heritage and for day-to-day operations, like the White House or historical housing at military installations. These assets are referred to as Multi-use Heritage Assets. Unlike normal Heritage Assets, the cost of acquisition, betterment, or reconstruction of all Multi-use Heritage Assets is capitalized as general PP&E and is depreciated. Often, you can't determine the cost of Heritage Assets or the cost is irrelevant to their significance. Like Stewardship Land, the government does not expect to use these assets to meet its obligations. The most relevant information about Heritage Assets is non-financial. The public entrusts the government with these assets and expects their preservation.

Stewardship Land is not acquired for, or in connection with, General PP&E. The term "acquired for, or in connection with" is defined as including land acquired with the intent to construct General PP&E and land acquired in combination with General PP&E, including not only land used as the foundation, but also adjacent land considered to be the common grounds to General PP&E. Without exception, all land provided to the DoD from the public domain, or at no cost, is classified as Stewardship Land, regardless of how it's used. Therefore, public domain or no-cost land, used in a General PP&E context, is classified as Stewardship Land, not as General PP&E land. Stewardship Land is federally-owned land set aside for the use and enjoyment of present and future generations and land on which military bases are located. The government doesn't expect to use Stewardship Land to meet its obligations, unlike the assets listed in the Balance Sheet. It is measured in non-financial units such as acres of land and lakes, miles of parkways, and miles of wild and scenic rivers. This category excludes lands administered by the Bureau of Indian Affairs and held in trust.

Now let's look the financial statements.





## PP&E Requirements (cont.)



### **Annual Financial Statements include:**

- **Management Discussion and Analysis**
- **Principal Statements and Related Notes**
- **Required Supplementary Stewardship Information, if applicable**
- **Required Supplementary Information, if applicable**
- **Other Accompanying Information, if applicable**

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Documentation for Audits of PP&E

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Audit requirements for federal financial statements are contained in OMB Bulletin No. 01-02. The preparation of the annual financial statements is the responsibility of agency management. The CFO of each agency should prepare a policy bulletin or guidance memorandum that guides the agency's fiscal and management personnel in the preparation of the annual financial statements.

OMB Bulletin No. 01-09 defines the form and content for federal agency finance statements that are required to be submitted to the OMB and Congress pursuant to the requirements of the CFO Act, as amended by the Reports Consolidation Act of 2000. Management's discussion and analysis (also called Overview of the Reporting Entity) section of the financial statements should present an integrated discussion of agency program and financial performance that satisfies the requirements for a summary of performance required by the Reports Requirements Act and SFFAS No. 15.

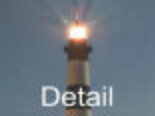

The principal statements include the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing, Statement of Custodial Activity, and if applicable, Notes to Principal Statements. Note 10 is of particular interest for the disclosure of PP&E and will be discussed in a few minutes.

Required supplementary information includes the management discussion and analysis. It should address the entity's mission and organizational structure; performance goals, objectives, and results; financial statements; systems, controls, and legal compliance; and possible future effects on the entity of the most important existing, currently-known demands, risks, uncertainties, events, conditions, and trends.



Other accompanying information includes performance measures, revenue forgone, tax burden/tax gap, and tax expenditures with directed flows of resources.

Let's discuss the PP&E reporting in the Balance Sheet.



## PP&E Requirements (cont.)

### Example of Assets Section on Balance Sheet

Department of Defense  
Under Secretary of Defense (Comptroller)  
**BALANCE SHEET**  
As of XXXXXX XX, XXXX and XXXX DRAFT

**1. ASSETS (Note 2)**

A. Intragovernmental:

1. Fund Balance with Treasury (Note 3)

a. Entity

b. Non-Entity Seized Iraqi Cash

c. Non-Entity-Other

2. Investments (Note 4)

3. Accounts Receivable (Note 5)

4. Other Assets (Note 6)

5. Total Intragovernmental Assets \_\_\_\_\_

B. Cash and Other Monetary Assets (Note 7)

C. Accounts Receivable (Note 5)

D. Loans Receivable (Note 8)

E. Inventory and Related Property (Note 9)

F. General Property, Plant and Equipment (Note 10) 440,898.6

G. Investments (Note 4)

H. Other Assets (Note 6) \_\_\_\_\_

**2. TOTAL ASSETS** XXXX,XXX.X

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We discussed what the annual financial statements should include. Now, we are going to look at an example of a Balance Sheet Assets Section. In this section, there is an account called General Property, Plant, and Equipment. This account shows the Net Book Value of the General Property, Plant, and Equipment.

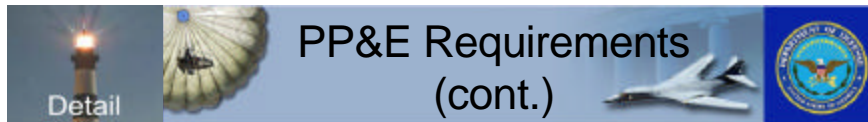
When an audit is conducted of the Balance Sheet, the auditor first looks at the total in Line 1F, General Property, Plant, and Equipment. The dollar amount on the Balance Sheet for Line 1F is compared to the Net Book Value in Note 10, General PP&E, Net; Line 1J, Total General PP&E.

We can see that the dollar amount on the Balance Sheet of \$440,898.6 compares to the dollar amount of \$440,898.6 on Note 10, General PP&E, Net, as shown on the next slide.

The detail for the General Property, Plant, and Equipment account on the Balance Sheet is provided in Note 10, General PP&E, Net.

Let's look at Note 10 to see the detail information.





## Minimum requirements:

- **Cost, associated accumulated depreciation, and book value**
- **Estimated useful life**
- **Depreciation method**
- **Capitalization threshold, including any changes in threshold during the period**
- **Restrictions on the use or convertibility of General PP&E.**

Note 10. General PP&E, Net						
As of September 30	2004					
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term 2-5 Or	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,382.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	(947,711.7)	\$ 440,898.6	\$ 446,308.9

<sup>1</sup> See Note 15 on Capital Lease Liability for additional information

Legend for Valuation Methods:

S/L = Straight Line N/A = Not Applicable

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Documentation for Audits of PP&E

L1-8

Note 10, General PP&E, Net, provides detail information to support Line item 1F, General Property, Plant, and Equipment, on the Balance Sheet. Appendix B in the Student Guide, includes an example of Note 10.

This note contains the major classes of General PP&E that are reported by the Department. Some examples of major classes of General PP&E include, but are not limited to, buildings and structures, furniture and fixtures, equipment, vehicles, and land.

The minimum disclosures required for each major class of General PP&E are:

- Cost, associated accumulated depreciation, and book value
- Estimated useful life
- Methods of depreciation
- Capitalization threshold, including any changes in threshold during the period
- Restrictions on the use or convertibility of General PP&E.

The Statement of Federal Financial Accounting Standards No. 23, titled Eliminating the Category Nation Defense Property, Plant, and Equipment, was issued in May 2003. This standard, which is effective for the accounting periods beginning after September 30, 2002, established GAAP for valuing and reporting military equipment in federal financial statements.

Let's discuss the FASAB accounting standards hierarchy.





## PP&E Requirements (cont.)



**The Federal Accounting Standards Advisory Board (FASAB) is the standards-setting body for federal government entities.**

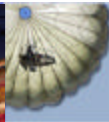
**Two other important standards-setting boards are the Financial Accounting Standards Board (FASB) for non-governmental entities and the Governmental Accounting Standards Board (GASB) for state and local governments.**



Upon enactment of the Chief Financial Officers Act (CFOA) (which we will discuss later), the Secretary of the Treasury, the Director of the Office of Management and Budget, and Comptroller General established the FASAB to develop standards for the newly required financial statements.

More recently, the American Institute of Certified Public Accountants (AICPA) recognized the FASAB as the standards-setting body for federal government entities. The AICPA is the national, professional organization for all Certified Public Accountants (CPAs). This is significant in that, for the first time, the federal government will have accounting standards widely recognized by CPAs as presenting a clear picture of the federal government's financial position. In addition to the FASAB, the AICPA has designated only two other accounting standard setters: the Financial Accounting Standards Board (FASB) for nongovernmental entities and the Governmental Accounting Standards Board (GASB) for state and local governments. Federal government entities will be able to obtain audit opinions indicating whether the financial statements are presented in conformity with generally accepted accounting principles (GAAP). The Chair of the AICPA stated "This is another marker in the progress of the federal government to improve its financial management and accountability. It is also a good example of private/public sector cooperation whose outcome is the greater protection of the public interest."





## PP&E Requirements (cont.)



### **Statement of Federal Financial Accounting Standards (SFFAS)**

#### **Technical Bulletins**

#### **Interpretations**

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L1-10

The standards issued by the FASAB are called the Statement of Federal Financial Accounting Standards (SFFAS) and are designed to implement GAAP. The importance of GAAP was expressed by the Comptroller General, when he described it as being like the Good Housekeeping Seal of Approval. He stated that it's language that communicates outside of government which is important as more private business practices are incorporated into government. FASAB (and therefore GAAP) lends additional credibility to the audited financial statements.

In addition to establishing federal accounting standards and financial reporting, the SFFAS play a major role in fulfilling the government's duty to be publicly accountable. They are used for assessment purposes such as examining the government's accountability, efficiency, and effectiveness. They can also be used to assess the economic, political, and social consequences of the allocation and various uses of federal resources. In concert with the SFFAS are Interpretations. Upon request, the Board issues Interpretations to clarify, implement, endorse, or otherwise facilitate officially established accounting principles.

Sometime it takes a while for the SFFAS to be issued as they may require extensive due process, including appointing task forces and holding public hearings. So the FASAB uses Technical Bulletins to provide timely guidance. Technical Bulletins are issued to provide guidance on certain financial accounting and reporting problems of any federal financial reporting entity. Their website has a form to communicate technical inquiries related to accounting by entities of the federal government, and they normally respond in 1 to 2 days.

In this lesson, we will examine the SFFAS applicable to software and equipment compliance requirements.





## PP&E Requirements (cont.)



### Internal Use Software guidance:

- **SFFAS No. 10: Accounting for Internal Use Software, is the most significant SFFAS pertaining to software.**
- **SFFAS No. 6: Accounting for Property, Plant, and Equipment, also contains information related to software.**



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L1-11

SFFAS Number (No.) 10 discusses internal use software and classifies it as General PP&E used to provide general government services or goods. It's important to view the SFFAS, as well as pertinent regulations, in total since many have been updated or rescinded. For example, SFFAS No. 6 standards relating to internal use software are later redefined in SFFAS No. 10. Consider that SFFAS No. 6 prohibited the capitalization of the cost of internally developed software unless management intended to recover the cost through user charges and the software was to be used as general PP&E.

In 2002, the DoDIG audited the Department for compliance with internal use software accounting standards and found that although more than \$19 billion annually had been budgeted, less than \$1.4 billion had been reported. The most prevalent problem came from expensing rather than capitalizing software on the financial statements. In short, the Inspector General found that components were not complying with SFFAS Nos. 6 and 10, thereby understating the software asset account (1830). There are still problems as evidenced by the February 2005 GAO testimony before Congress, stating that we can't satisfactorily determine what PP&E is owned because it continues to be improperly reported. Why is this so important? Without reliable asset information, no one knows what is owned, where it is, and in what condition it exists. The Department can't effectively (1) safeguard them from deterioration, theft, or loss; (2) account for new acquisitions or disposals; (3) ensure that they are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.





## PP&E Requirements (cont.)



### Equipment guidance:

- **SFFAS No. 6: Accounting for Property, Plant, and Equipment**
- **SFFAS No. 8: Supplementary Stewardship Reporting**

In addition to rules on internal use software as we just discussed, SFFAS No. 6 contains standards on federally owned PP&E, deferred maintenance on PP&E, and cleanup costs. It further defines the four categories of PP&E: 1) General PP&E was earlier defined as PP&E used to provide general government goods and services, 2) Federal Mission PP&E is PP&E that have special characteristics set by the FASAB, 3) Heritage assets are those that possess significant educational, cultural, or natural characteristics, and 4) Stewardship Land is land other than that land included in General PP&E.

SFFAS No. 8 primarily examines the Stewardship Land category.

But let's look at a few more of the FASAB standards before we summarize their current status.





## PP&E Requirements (cont.)



### Equipment guidance:

- **SFFAS No. 11: Amendments to Accounting for Property, Plant, and Equipment (amends SFFAS Nos. 6 and 8)**
- **SFFAS No. 16: Amendments to Accounting for Property, Plant, and Equipment (amends SFFAS Nos. 6 and 8)**

SFFAS No. 11 is significant for several reasons. It eliminated the category of Federal Mission PP&E and classified space exploration equipment as General PP&E. The Federal Mission category was eliminated because there was no standard definition and this led to some confusion. After eliminating the Federal Mission category, a new one was created called National Defense PP&E. This category consists of DoD weapons systems and support PP&E. It also includes the preserved ships held by the Maritime Administration's National Defense Fleet.

SFFAS No. 16 is similar to No. 11 in that it amended both SFFAS Numbers 6 and 8; however, it aimed to remedy confusion over multi-use heritage assets. These are assets that have a heritage characteristic and are also used for general government operations such as the Pentagon. SFFAS No. 16 re-defined multi-use heritage assets as heritage assets whose predominate use is general government operations. Those heritage assets that have incidental use in government operations are simply referred to as heritage assets.





## PP&E Requirements (cont.)



### Equipment guidance:

- **SFFAS No. 23: Eliminates the Category National Defense Property, Plant, and Equipment (rescinds SFFAS No. 11, and amends SFFAS Nos. 6 and 8)**
- **Military equipment is now capitalized as General PP&E**



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L1-14

SFFAS No. 11 established that all acquisition, reconstruction, and betterment costs of multi-use heritage assets (as just defined) be capitalized as general PP&E and depreciated over their service life. The intent of the amendment is to establish consistent accounting for the cost of PP&E predominantly used in general government operations. Additionally, under SFFAS No. 11, costs for National Defense PP&E were expensed and the condition, valuation, and any deferred maintenance information was provided off balance sheet.

SFFAS No. 23 eliminates the category of National Defense PP&E and reclassifies its items to the General PP&E category. It mandates that these costs be capitalized and depreciated (except for the cost of land and land improvements that produce permanent benefits). Up to this point, the rule had been to expense military equipment and only report their quantities.

Next we review other requirements that have a significant impact on your application of the FASAB Standards.





## PP&E Requirements (cont.)



**PP&E compliance requirements are contained in the DoD 7000.14-R, Financial Management Regulation. Specific volumes and chapters of interest:**

- **Volume 4, Chapter 6 - Department's PP&E accounting standards and policy.**
- **Volume 1, Chapter 7- applicable usage of the Standard General Ledger accounts.**
- **Volume 2B, Chapter 9, Defense Working Capital Funds and Volume 11B - specific financial management requirements, systems, and functions.**



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L1-15

Volume 4, Chapter 6, of the FMR contains the Department's PP&E accounting standards and policy. This chapter provides definitions and applications critical to compliance with the Department's requirements. It also includes use of the Standard General Ledger (SGL) accounts, although they are shown in Chapter 7, Volume 1.

Volume 2B, Chapter 9, contains information about Defense Working Capital Funds, as does Volume 11B. It defines software as both operating software and application software, and discusses topics such as depreciation (as also defined in SFFAS No. 6), capitalization, and capital budgeting, among others. Equipment compliance requirements include discussions on how to handle several unique situations such as transfer-in of equipment with pre-existing depreciation schedules and purchase of software or equipment to meet a customer requirement. This is a good place start for those involved in a DWCF who need additional information.

Instructions for reporting the notes to the financial statements are found in the DoDFMR, Volume 6B, Chapter 10, at Note 10, General PP&E, Net.





## PP&E Requirements (cont.)



### Regulatory requirements for software and equipment compliance:

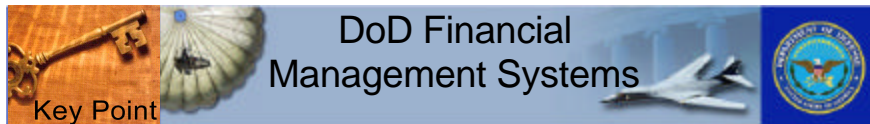
- **GAO/President's Council on Integrity and Efficiency (PCIE), Financial Audit Manual (FAM)**
- **OMB Circulars.**



The Government Accountability Office/President's Council on Integrity and Efficiency, Financial Audit Manual is used for performing financial statement audits of federal entities. It describes how the methodology relates to relevant auditing and attestation standards and OMB guidance, and outlines key issues to be considered in using the methodology. The checklists included in the manual can contribute significantly to your readiness upon arrival of an auditor.

OMB guidance includes Circulars on auditing financial statements and it provides independent analysis of issues affecting the federal executive financial community. Much of their work is through the DoDIG office in order to maximize their effectiveness.





**Federal Financial  
Management  
Improvement Act  
(FFMIA)**

**President's  
Management Agenda  
(PMA)**



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L1-17

Both the Federal Financial Management Improvement Act (FFMIA) and the President's Management Agenda (PMA) advance the need for financial management reform. This guidance intends for the Department to conform to the U.S. Standard General Ledger (USSGL) and applicable federal accounting standards, and establish financial management systems that support full disclosure of federal financial data. The problem is, the Department does not yet fully comply due to several short-comings including financial management systems that are unable to meet current and future requirements.

Next we examine more guidance, starting with the FFMIA.





## DoD Financial Management Systems (cont.)



### **Federal Financial Management Improvement Act (FFMIA) of 1996**

**Agencies shall implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level.**

**<http://www.dod.mil/comptroller/fmfia>**

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L1-18

The FFMIA (Public Law 104-208) builds upon and complements the Chief Financial Officers Act of 1990, the Government Performance and Results Act of 1993, and the Government Management Reform Act of 1994. The FFMIA was enacted because Congress found that:

- federal accounting standards had not been uniformly implemented in financial management systems for agencies
- federal financial management continues to be seriously deficient, and federal financial management and fiscal practices have failed to identify costs fully, reflect the total liabilities of congressional actions, and accurately report the financial condition of the federal government
- federal accounting practices do not accurately report financial results of the federal government or the full costs of programs and activities
- waste and inefficiency in the federal government undermine the confidence of the American people in the government and reduce the federal government's ability to address vital public needs.

Because of these findings, agencies must incorporate accounting standards and reporting objectives established for the federal government into their financial management systems to rebuild their accountability and credibility.

Recommendations included:

- auditors to report on agency compliance
- agency head to determine compliance of financial management systems.

Let's learn about the DoDFMR.





## DoD Financial Management Systems (cont.)



### **DoD Financial Management Regulation**

**This regulation provides all the DoD components with the policies, regulations, and procedures within the area of responsibility of the Comptroller, Department of Defense.**

**<http://www.dod.mil/comptroller/fmr/>**

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Documentation for Audits of PP&E

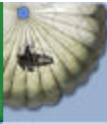
L1-19

The DoDFMR consists of 15 volumes and contains general financial information on budgeting, accounting policy, disbursing policy, reporting policy, military pay, civilian pay, travel policy, contract policy, reimbursement operations, special accounts, non-appropriated funds, financial management education and training, and security assistance policy and procedures.

When we go through the validation process, it is important to understand regulations that are applicable to PP&E, such as the DoDFMR, Volume 4, Chapter 6, Property, Plant, and Equipment. This provides guidance for properly accounting for the different categories of PP&E.

Now let's look at the GAO Government Accounting Standards.





## DoD Financial Management Systems (cont.)



### **General Accountability Office (GAO) Government Accounting Standards**

**Defines the auditor's responsibility and provides an overall framework for ensuring that auditors have the competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work.**

**<http://www.gao.gov/govaud/ybk01.htm>**

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L1-20

GAO Government Auditing Standards contain statements of the auditors' responsibilities and provide an overall framework for ensuring that auditors have competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work.

The standards and guidance contained in this document are often referred to as generally accepted government auditing standards (GAGAS). They are to be followed by auditors and audit organizations when required by law, regulation, contract, agreement, or policy.

Now let's discuss what the Department is doing to correct some system weaknesses.





## DoD Financial Management Systems (cont.)



**Financial management systems have been identified as a material weakness.**



**“...inability to collect and report financial and performance information that is accurate, reliable, and timely.”**

**Source: GAO Audit Report**

Financial Management Systems is one of 11 financial statements material weaknesses identified for the Department. The auditors indicate this deficiency results from the “...inability to collect and report financial and performance information that is accurate, reliable, and timely.”

To correct these weaknesses, the USD(C) approved the DoD Financial and Feeder Systems Compliance Process. The goal of this process is to ensure that critical financial and feeder systems are compliant with applicable federal financial management systems requirements and to enhance the systems’ capabilities to provide timely and accurate financial data to aid decision making. While several Defense organizations have moved substantially toward implementing the DoD Financial and Feeder Systems Compliance Process, there is still work to be done. Additionally, the Secretary of Defense established a Department-wide Financial Management Modernization Program. The purpose of the program is to ensure reliable, accurate, and timely financial management information upon which to make effective management decisions. The Financial Management Modernization Program was renamed the Business Management Modernization Program (BMMP) on May 20, 2003.

If you are wondering how big the problem is for the Department, consider this. Achieving a clean audit requires standardizing the way services and agencies transact business and currently we use at least 5,500 separate and incompatible financial and inventory management systems.

Let's see what the Department is doing to help resolve material weaknesses.





## DoD Financial Management Systems (cont.)



**The Department's actions include establishing the Business Management Modernization Program (BMMP) or Business Transformation Initiative. BMMP consists of three increments:**

- Increment 1 – clean audit by FY07
- Increment 2 – reform acquisition and asset valuation
- Increment 3 – reform the planning, programming, budgeting, and execution process

Any process that requires money – such as ordering bolts for a military command, or a blood test in a military hospital – is a business transaction.

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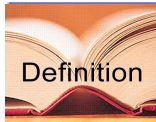
L1-22

To support compliance, and in response to well documented and often publicized financial (and business) problems, the Department implemented the BMMP or Business Transformation Initiative. It is the Department's effort to transform the way it does business, not just the way it keeps records. BMMP is divided into three increments, with increment 1 scheduled to finish in FY 2007. Its objective is to achieve a clean audit of the Department's consolidated financial statements. Goals for increment 2 include reforming the Department's acquisition practices; asset valuation; and force management through position accountability and visibility. For increment 3, the Department intends to reform the planning, programming, budgeting, and execution process. Each increment is updated by versions that act as blueprints for achieving the increment goals which are designed to move through a series of Business Enterprise Architectures (BEA).

The BEA is designed to consolidate and standardize all of the Department's financial reporting systems to enhance military readiness. It helps describe how the Department's processes and systems work together to ensure accurate and timely financial information is available for decision makers. The Department now has established integrated goals, objectives, measures, and targets, and initiated a single Department-wide information technology registry to track all business systems.

Aligned to a key BMMP objective, the Financial Improvement Initiative seeks to attain an unqualified audit opinion on the DoD-wide financial statements by FY 2007. To do this requires that subordinate reporting entities identify their deficiencies and work to resolve them as quickly as possible.





## DoD Financial Management Systems (cont.)

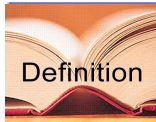


**Work performed by the Joint Financial Management Improvement Program (JFMIP) is now in the Office of Federal Financial Management (OFFM).**

- **Coordinates the development and publication of functional requirements for financial management systems.**
- **Responsible for testing and certification of core financial system commercial off-the-shelf (COTS) software.**
- **OUSD(C) requires internal use software to be accounted for in an automated property system that is JFMIP/OFFM compliant.**

The Joint Financial Management Improvement Program (JFMIP) is a joint program of the Department of the Treasury, Government Accountability Office, Office of Management and Budget, and Office of Personnel Management. The JFMIP coordinates the development and publication of functional requirements for financial management systems. In addition, a separate Program Management Office (PMO) is responsible for the testing and certification of commercial off-the-shelf (COTS) core financial system software for use by federal agencies. Vendors like the feedback they are receiving as the government continues to refine its requirements. The Department is lowering its cost and risk as the result of the PMO's requirements issuance and testing and qualification processes. Increasingly, the core financial system software requirements are clear, testing protocols are transparent, and agencies increasingly implement COTS software without having to customize source code to meet federal requirements. OUSD(C) direction regarding internal use software is that it must be accounted for in an automated property system that is JFMIP compliant.





## DoD Financial Management Systems (cont.)



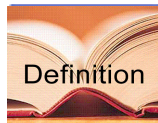
**The Chief Financial Officers Council (CFOC) has also acquired some of the work previously done by the JFMIP.**

- **Consists of the CFOs and Deputy CFOs of the largest federal agencies, and senior officials of the OMB and Treasury.**
- **Established under the CFOA to, among other things, consolidate and modernize its members' financial systems.**

However, some work of the JFMIP has transitioned to the Chief Financial Officers Council (CFOC) and the Office of Federal Financial Management (OFFM). All financial management system requirements documents and other guidance issued by the JFMIP have been transferred to OFFM, where they remain in effect. As needed, the OFFM issues guidance memoranda to clarify any transition issues. So who are the CFOC and the OFFM?

The CFOC consists of the CFOs and Deputy CFOs of the largest federal agencies and senior officials of OMB and Treasury. They work collaboratively to improve financial management in the federal government. The Council was established under the CFO Act of 1990 to “advise and coordinate the activities of the agencies of its members on such matters as consolidation and modernization of financial systems, improved quality of financial information, financial data and information standards, internal controls, legislation affecting financial operations and organizations, and any other financial management matter.”





DoD Financial  
Management Systems  
(cont.)



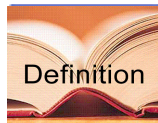
## Office of Federal Financial Management (OFFM)



The OFFM was created within the OMB to promulgate federal financial management policy. Their responsibilities include implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFO Act.

Let's now look at some OMB Circulars that prescribe standards for financial management systems.

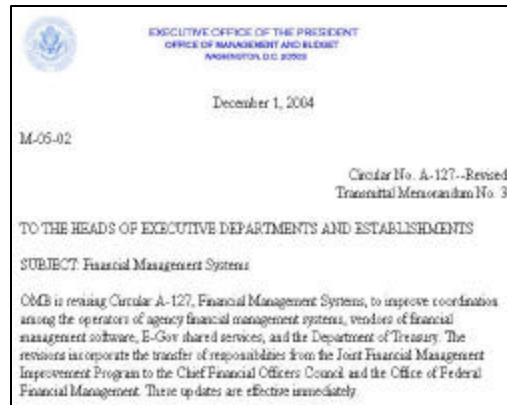




## DoD Financial Management Systems (cont.)

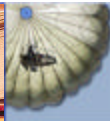
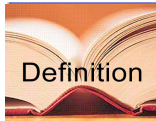


### OMB Circular No. A-127, Financial Management Systems



OMB Circular A-127 prescribes the policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. It has been updated twice, most recently on December 1, 2004, with Transmittal Memorandum No. 3. Circular A-127 provides for certain financial management system requirements such as a classification structure consistent with the U.S. Standard General Ledger maintained by the Treasury. It further provides that financial management systems must contain common agency data elements to record transactions, common transaction processing of similar events, consistent internal controls applied throughout the system, and efficient transaction entry to eliminate redundant data entry. One of the more relevant aspects of this circular is its direction over agency financial management reporting. Circular A-127 establishes specific criteria, including that financial management systems will provide timely and useful information as prescribed by the OMB and Treasury.





## DoD Financial Management Systems (cont.)



### OMB Circular No. A-136, Financial Reporting Requirements



OMB Circular A-136 is a relatively new one, dated December 21, 2004. It establishes a central point of reference for all federal financial reporting guidance for entities required to submit audited financial statements, interim financial statements, and Performance and Accountability Reports (PARs). It contains background information on federal financial reporting, discusses entities to which Circular A-136 applies, provides federal financial reporting policy, references the relevant bulletins and memoranda for specific guidance, and provides contact information for inquiries.



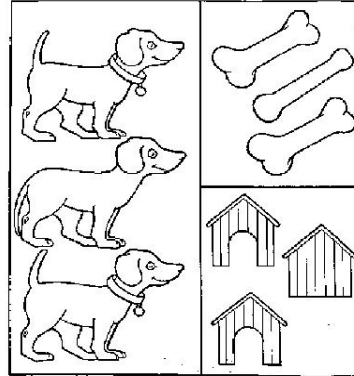


## Preventing Inconsistencies



### Relevant inconsistencies

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Consistency is important to the overall financial process. Preventing inconsistencies is a way to manage risk. Those relevant to documentation for audits of PP&E include inconsistencies that create a material weakness.

Let's have a look at how to minimize risks by preventing inconsistencies.





## Preventing Inconsistencies (cont.)



### How to minimize risks:

- **Re-evaluate policies and procedures to provide consistent guidance.**
- **Update property accountability records based on a physical inventory.**
- **Ensure controls over the accuracy and completeness of acquisition costs, date, description, and location.**
- **Source documents are valid, accurate, and reliable.**

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This slide reflects actions you might take to minimize risk. Often inconsistencies lie with policies and procedures that cause confusion and are therefore treated differently from reader to reader. Policy must be reviewed periodically to ensure that it continues to be relevant and doesn't evoke various interpretations. Tasks as seemingly simple as ensuring that inventory records match actual counts may fall victim to inconsistent application. Some agencies have established poor internal controls and management oversight, allowing inconsistent application or interpretation of guidance. While the task of ensuring full data collection on new and existing PP&E is given full attention, it's also important to ensure that current practices are in line with all policies and procedures. It's everyone's responsibility to ensure that source documents (or inputs) are valid, accurate, and reliable.

The bottom line is to ensure the rights associated with source documents, like costs, dates, appropriation, and so forth, are accurately documented and input into accountability and accounting systems.





## Preventing Inconsistencies (cont.)



**PP&E previously classified as National Defense PP&E was expensed – now called Military Equipment and is capitalized.**

- National Defense PP&E eliminated at the beginning of FY04
- Consists of weapon systems and support PP&E used to execute military missions
- Department's biggest problem is lack of historical cost information



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L1-30

Audit deficiencies continue to result from the category previously known as National Defense PP&E. The category was eliminated at the beginning of FY 2004; it previously consisted of PP&E components of weapons systems and support PP&E used to execute military missions. This category also included vessels preserved by the Maritime Administration's National Defense Reserve Fleet.

Before the category of National Defense PP&E was eliminated, the acquisition costs were expensed in the period incurred. Now, costs of these types are capitalized and depreciated (except for land and land improvements). The initial capitalization should be based on the item's historical costs including any major improvements or modifications. SFFAS No. 23 contains additional details on how to treat this category.

Audits have revealed that the DoD is not reporting the cost of military equipment in accordance with generally accepted accounting principles, primarily due to the lack of historical cost information.





## Preventing Inconsistencies (cont.)



### **PP&E cost and depreciation inconsistencies:**

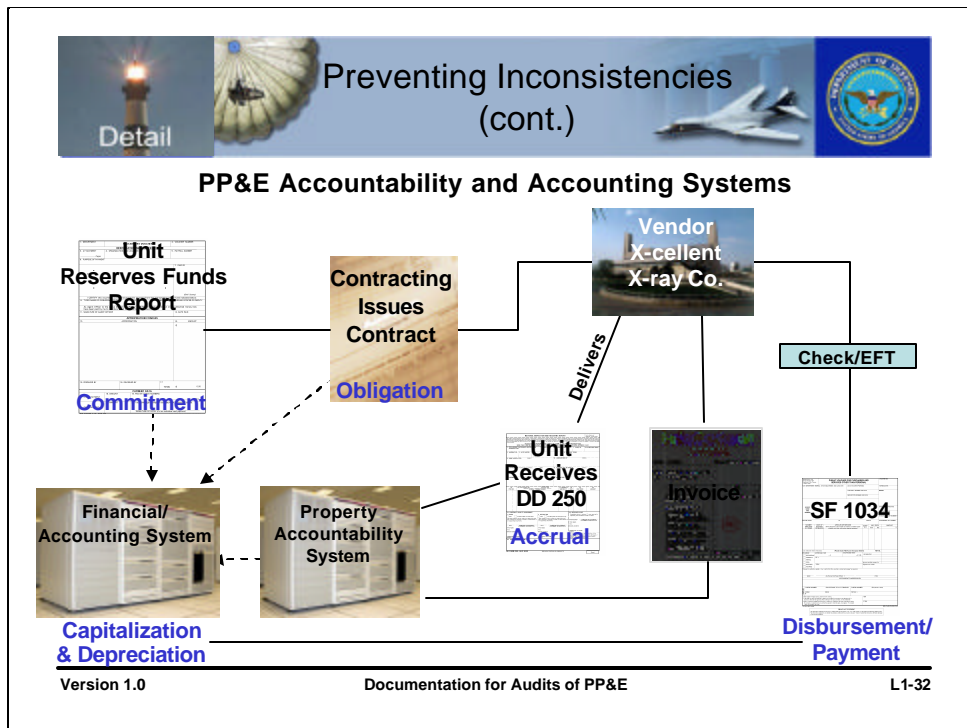
- **Insufficient supporting documentation**
- **Property and logistics systems not integrated into financial systems**



To minimize the risk of continued erroneous reporting, you should ascertain the need to develop documentation for the cost and depreciation of these items. Other areas of concern include insufficient supporting documentation, particularly for PP&E that was purchased many years ago, and legacy property and logistics systems that are not integrated with acquisition and financial systems, preventing capture of the acquisition cost, modification cost and upgrades, or the calculation of depreciation.

In speaking of legacy systems, the last point was raised by the DoDIG when he stated that integrating information from multiple sources in an organization as complex and diverse as DoD lends itself to continued inconsistencies and inaccuracies. So does this mean we have no chance of achieving an integrated system? No. As we saw while discussing DoD Financial Management Systems, the Department is working to resolve this issue as quickly as funding and time will allow.





Audit findings within the PP&E often involve inventory control issues. Inventory control is the control of materiel by accounting and physical control. So what's the difference you might ask? Accounting control is the proper recording and reporting of inventories. Physical control ensures that safeguards for receiving, storing, handling, and issuing materiel are adequate. A physical inventory tests the accounting and physical control of an item's storage location and count.

Accountability systems track the quantities of PP&E and may contain applicable depreciation schedules. They maintain the physical control documentation necessary to ensure positive tracking of all PP&E. Accounting systems are more concerned with the monetary values of the PP&E documented in the accountability systems.

Inconsistencies may develop due to lack of training, lack of internal control, or lack of leadership. For example, a recent audit finding involved millions of dollars of excess materiel that accumulated because maintenance center personnel wanted to avoid the negative impact of writing off the excess inventory on the financial statements.





## Preventing Inconsistencies (cont.)

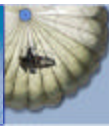


### **Physical inventory should assure:**

- **periodic, independent verification of the accuracy of both the accountability records and accounting records**
- **reconciliation of subsidiary property accountability records to the general ledger accounts**
- **source documentation is adequate to support the inventory.**

Inventories should assure the existence and completeness of PP&E. The DoDFMR describes this as a “book to floor and floor to book” process. The accountability records and the accounting records must be based on the same information. This requires a reconciliation process between the property accountability systems, accounting systems, and source documentation.





## Preventing Inconsistencies (cont.)



### General PP&E, buildings and other structures:

- placed-in-service date
- useful life
- retirement date
- physical existence
- supporting documentation
- book cost.



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L1-34

Prior audit reports found that sufficient controls were not in place to ensure that the placed-in-service and retirement dates were supported or properly established. The primary purpose of ensuring the accuracy of these dates lies in the requirement to show depreciation over the useful life of the PP&E. Additionally, the book costs of buildings and other structures must be supported by sufficient documentation. Accurate financial statements reporting requires that assets be recorded at full cost, including the costs to bring the asset to a form and location suitable for its intended use.

Property held by contractors, regardless of the value, must be accounted for on property records. However, when the value exceeds the capitalization threshold, it must be included on the entity's Balance Sheet. That said, recent audit findings include a component's lack of internal control to ensure proper accountability of government-furnished property held by contractors. Furthermore, personal property (particularly software) held by contractors is not properly reported and accounted for based on the capitalization rules for General PP&E.

Your ability to locate and validate this type of information is imperative to clearing these deficiencies. By anticipating the audit requirements, and pre-validating the information that will be inspected, you will achieve a clean audit.





## Statutory Requirements



**Base realignment and closure (BRAC) and formerly used defense sites (FUDS) costs must be monitored for statutory compliance and proper treatment in the financial statements.**

**The Management Discussion and Analysis (MDA) Report in the financial statements addresses the organization's legal compliance.**

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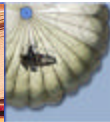
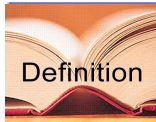
L1-35

Base Realignment and Closure (BRAC) sites and formerly used defense sites (FUDS) costs that relate to General PP&E, including acquired land and stewardship land, must be included in the financial statements. Costs for restoration, such as when a military resort is returned as a public nature preserve and reversion costs like that of an installation following BRAC reverting to a city, result from specific statutory requirements that must be followed by the Department.

The Management Discussion and Analysis (MDA) report in the financial statements should address the organization's legal compliance, among other topics. It may be the only place for management to convey in a concise manner the entity's success or identify areas of legal compliance that need improvement. This is important because senior leadership has limited time to read numerous individual reports, but can rely to this overall analysis to grasp the heart of the matter.

But what are the underlying laws relevant to financial statements audits? Let's examine the primary legislation on the next slide.





## Statutory Requirements (cont.)



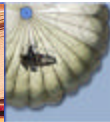
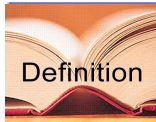
### **Chief Financial Officers Act of 1990:**

- **mandates a five-year Financial Management Plan**
- **requires annually audited financial statements**
- **transfers much of the standard-setting authority from the GAO to the OMB**
- **establishes the Chief Financial Officers**
- **provides for increased agency accountability.**

Congress mandated, through the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, that federal agencies annually prepare auditable financial statements. This was the first such requirement in federal history and posed some challenges to the activities of federal participants. For example, consolidated auditable financial statements must be produced from the Department's 19 subordinate financial statements reporting entities. As of FY 2004, only 7 of the 19 have received a favorable audit opinion on their financial statements.

The CFOA remains significant as other laws have been added to complement and refine Congressional intent.





## Statutory Requirements (cont.)



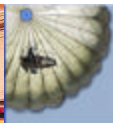
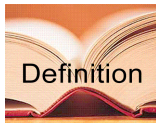
### **CFOA intends to improve:**

- **information for management**
- **financial management systems and accounting data**
- **management**
- **accountability and measure performance**
- **internal controls**
- **communications**
- **cost savings and efficiencies**
- **uniform accounting standards.**

So what is Congress's intent through the CFOA?

With the underlying goal to provide federal leadership with quality information in order to make better decisions, the CFOA leads toward improvement in financial management systems and internal controls aimed to negate waste, fraud, and abuse of resources. These enhancements will also ensure the production of complete, reliable, timely, and consistent financial information for use by the executive and legislative branches in the financing, management, and evaluation of programs. The activities that are performed in compliance with the CFOA contribute to our ability to produce audited financial statements that receive an unqualified opinion. As was mentioned earlier, a clean audit opinion will also provide Congress and senior Department leadership with a level of assurance in the validity and integrity of the financial data.





## Statutory Requirements (cont.)



### **Government Performance and Results Act (GPRA) of 1993:**

- **Requires agencies to develop strategic plans, set performance goals, and report annually.**
- **Intent of the act is to improve public confidence by holding agencies accountable.**

### **Government Management Reform Act (GMRA) of 1994:**

- **objectives are to improved financial management reporting**
- **required federal government to submit audited financial statements.**

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L1-38

The GPRA strengthens the CFOA by requiring agencies to develop strategic plans, set performance goals, and report annually on actual performance as compared to the those goals. The intent of GPRA is to improve public confidence by holding agencies accountable to achieve program results and to improve congressional decision making by clarifying and stating program performance goals, measures, and costs up front.

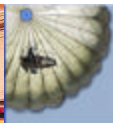
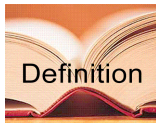
For GPRA to be successful, it depends on leadership that can link decision-making authority to accountability, create incentives, build expertise, and integrate management reforms.

The objectives of the GMRA are to improve the effectiveness of financial management reporting and require all federal agencies to submit audited financial statements beginning in FY 2006. The GMRA expanded the CFOA to apply to the 24 major agencies and their components, and required the federal government to consolidate all agency financial statements into a single set of audited financial statements.

Collectively, these and other items of legislation form the basis for the audit of property, plant, and equipment. They establish the legal framework from which directives, policies, and regulations are derived. That said, the purposes of performing financial statements audits include providing decision makers or financial statements users with assurance that the financial statements are reliable, internal controls are effective, and laws and regulations are complied with.

Let's look at one more key piece of legislation.





## Statutory Requirements (cont.)



**Generally Accepted Auditing Standards (GAAS) require auditors to give an opinion following an audit that classifies the results as:**

- **unqualified opinion – conform to GAAP**
- **qualified opinion – conform as above, except for the matter that makes the exception**
- **adverse opinion – do not conform to GAAP**
- **disclaimer opinion – appropriate when there is a lack of independence, scope limitations, or doubt, about the organization’s ability to survive, and for uncertainties like insufficient evidential matter.**

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L1-39

The financial statements are graded according to generally accepted auditing standards (GAAS) and the Department received a disclaimer on its 2004 audit, which means that there is more work needed. Let’s take a quick look at terms so we are clear on what a “disclaimer” means.

- **Unqualified audit opinion** – The financial statements present an entity’s financial position in conformity with generally accepted accounting principles.
- **Qualified audit opinion** – Except for the matter to which the qualification relates, the financial statements are in conformity with generally accepted accounting principles. For example, there may be a lack of evidential matter; restrictions on scope of the audit; or the auditor believes that financial statements contain a departure from GAAP, the effect of which is material.
- **Adverse opinion** – Financial statements do not present the entities’ position in conformity with GAAP.
- **Disclaimer audit opinion** – This indicates a lack of independence; there are scope limitations (inability to obtain sufficient competent evidential matter); when the auditor concludes that there is substantial doubt about the entity’s ability to survive (going-concern); and for matters involving uncertainties. Uncertainties may arise when there isn’t enough evidential matter to support an event.

Now let’s examine management responsibilities.





## Management Responsibilities



- **Understanding the relationships**
- **Training**
- **Audit follow-up**
- **Internal control/management control**



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L1-40

PP&E management responsibilities include understanding the relationship between source documentation and the financial statements. To gain more insight, it is helpful to develop a flowchart outlining the organization's processes. These flowcharts will point out various documents supporting the organization's activities. This is often referred to as the audit trail. Often, the document that creates an accounting event does not originate in an accounting system and could be processed by non-accountants. An example might be a receiving document that supports the PP&E on the financial statements. Since it becomes an accounting source document, it must meet the criteria established in the DoDFMR for supporting documentation. Often difficulty arises because of the various competing responsibilities of accounting and non-accounting management. What must be understood is that reliable documentation to support auditable financial statements is everyone's responsibility and ultimately benefits everyone. Documentation that cannot replicate the transaction is not sufficient and will lead to continued undesirable audit results.

Management must ensure that all personnel are trained to understand the impact of their job on the mission. That includes the long chain of events that leads to full funding for mission essential items, beginning with the critical (but often overlooked) step of maintaining adequate accessible documentation. Management is responsible for ensuring that audit deficiencies are corrected and practices are implemented to prevent future recurrence. Part of this responsibility lies in knowing your internal control or management control program. We will examine internal controls more closely in a few minutes.





## Management Responsibilities (cont.)



### GAO Audit of the FY 2004, U.S. Government Financial Statements:

- Federal government's inability to satisfactorily determine that PP&E held by the DoD were properly reported
- Department's deficiencies resulted from a lack of adequate systems and records
- Management must know where the PP&E is located and its condition
- Management must ensure that PP&E is safe from deterioration, theft, or loss, and can fully account for acquisitions and disposals.



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L1-41

The first material deficiency listed in the GAO audit of the federal statements is the federal government's inability to "satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department, were properly reported in the consolidated financial statements." For the Department, the deficiencies are conditions that prevent an entity's internal controls from providing reasonable assurance that misstatements, losses, or noncompliance of a material nature in relation to the financial statements do not exist. In fact, the primary reason GAO gives for the Department's failure is a lack of adequate systems and records to provide reliable information on assets.

Management has a responsibility to provide reliable asset information for the Department (and the federal government) to fully know the assets it owns and their location and condition. Management also has a responsibility to ensure that assets are safe from physical deterioration, theft, or loss; that they can fully account for acquisitions and disposals; that the assets are available for use when needed; that there are no unnecessary storage and maintenance costs or purchases of assets already on hand; and that they know the full costs of programs that use these assets.

Now let's discuss the Financial Improvement Initiative Phases.





## Management Responsibilities (cont.)



### Financial improvement initiative:

- **Discovery and Correction Phase**
  - allows correction of deficiencies
  - plan how to prevent future deficiencies
- **Validation Phase**
  - validate the correction made
  - management is responsible
- **Assertion Phase**
  - lets the DoDIG know you are audit ready
  - submission of the assertion package
- **Assessment Phase**
  - attests to the management assertion
  - if all approved, then audit is scheduled
- **Audit Phase**
  - required by the PMA and CFOA
  - provides information on internal controls

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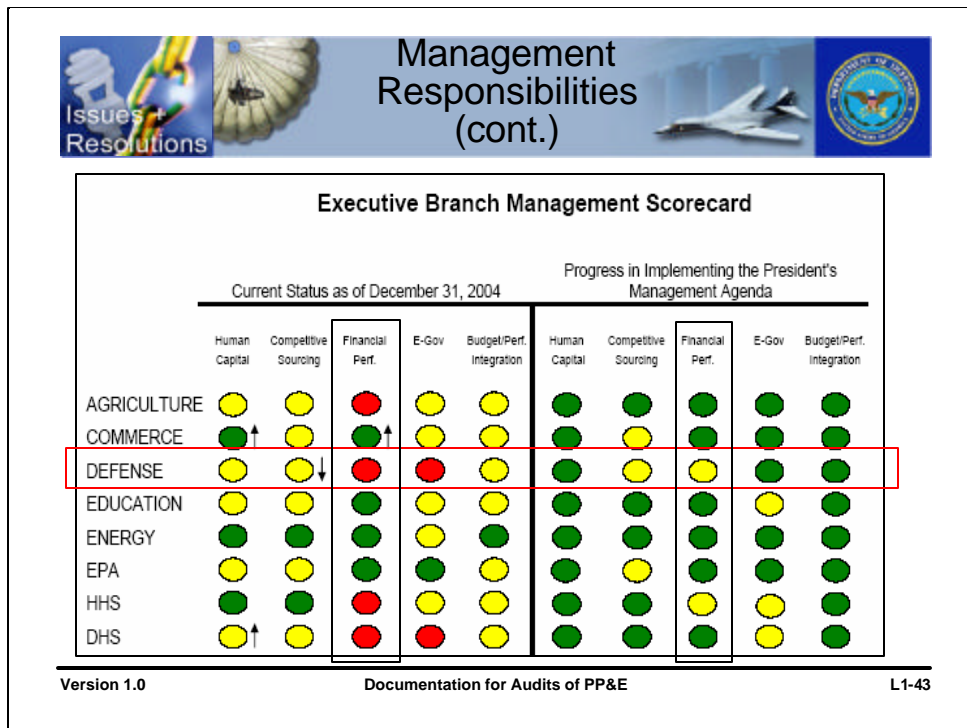
Documentation for Audits of PP&E

L1-42

The Financial Improvement Initiative consists of five (5) Major Phases, the Discovery and Correction, Validation, Assertion, Assessment, and Audit. Each phase has a specific function that requires management's attention. The Discovery and Correction Phase is intended to allow you to correct deficiencies and plan how to prevent them from recurring. This phase might include establishing audit committees like the Defense Finance and Accounting Service (DFAS) and developing business cases for systems changes. You might prepare and review a full set of financial statements quarterly to facilitate the annual requirement. The Validation Phase can validate the corrections made and enhance the credibility of the assertions. Management makes this request, which can be accomplished by DoDIG internal or external auditors, following initial comment from the DoDIG. Management also documents the processes, identifies applicable controls and systems, and ensures an auditable universe of transactions and the availability of supporting documentation. The Assertion Phase lets the DoDIG know you are ready for an audit, that is, that management has designated staff to work with the auditors and that documentation has been reviewed and is available to support the audit. This is accomplished by submission of the Assertion Package to the DoDIG based on DoDIG/OUSDC instructions. The package will also contain results of the Validation Phase among other documentation. The Assessment Phase attests to the management assertion and prepares for an audit. If everything is approved, then the audit is scheduled. The Audit Phase is required by the President's Management Agenda and the CFOA, as we learned earlier. The audit provides good information on assets and liabilities, cost visibility, and internal controls. And remember, as each component achieves success, they ultimately support the goal of achieving a Department-wide unqualified audit opinion measured through the Balanced Scorecard process.

Let's take a look at an example of a Balanced Scorecard.





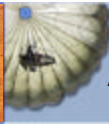
To manage effectively, you should know what your manager is concentrating on, and the President's Management Agenda (PMA) can help. The PMA was established by President Bush to improve management and performance of the federal government in five areas: improving financial performance, integrating budget and performance, strategically managing human capital, competitive sourcing, and expanding electronic government.

The Executive Branch Management Scorecard tracks how well the departments and major agencies execute the initiatives by employing the familiar stoplight scoring (red-yellow-green). Notice that there are two sides to the chart; on the left is the status side and on the right is the progress side. Also note that in the chart the third column refers to financial performance. Looking at the status side (or left side), it is shaded in red indicating that the "agency has any one of a number of serious flaws." On the progress side (or right side), the financial performance column is yellow indicating that "the initiative is in serious jeopardy" and requires "...significant management intervention."

Below the Executive Branch Scorecard, the scorecard concept is used by the Department as well as various entities within DoD to monitor the achievement of specific goals.

There is a PMA web reference located on a slide near the end of this lesson if you want to learn more about the PMA.





## Audit Coordination



### **Your coordination involves:**

- **allowing the auditor free access**
- **thinking like the auditor/know the auditor's process**
- **developing a method of organized folders**
- **making the audit preparation an on-going process**
- **working with all points-of-contact/using PBC list.**

Auditors are expecting free access to all personnel, facilities, records, reports, databases, documents, or other entity information needed to accomplish an announced audit objective. Remember, the best way to do well is to think like an auditor. Know the process so that you can anticipate the next step. Develop a method of organized folders that contains ready references to each question you know will arise. Make the audit preparation an on-going process and not something that you need to accomplish at the last minute. Coordinate with all the POCs who will be involved, regardless of location or organization.

Let's take a closer look at the Prepared By Client (PBC) list.





## Audit Coordination (cont.)



### Sample Prepared by Client (PBC) List

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	<b>General</b>				
1.	Current version of accounting policies and procedures manual with policies and procedures for Cash and Fund Balance with Treasury, Accounts Receivable, Inventory, Property and Equipment, Advances, Accounts Payable, Accrued Liabilities, and Net Position				
2.	Trial Balance (electronic)				
3.	Access to General Ledger detail				
4.	Crosswalk of accounts to Financial Statement line items				
5.	Statement of intra-departmental elimination entries for FYXXXX				
6.	Management's Discussion and Analysis/Overview				
7.	Draft Financial Statements (electronic)				
8.	Draft Footnotes to F/S (electronic)				
9.	FYXX year-end SF-132s				
10.	Detail Schedule of Undelivered Orders (electronic)				
11.	Post-closing trial balances (electronic)				
12.	Complete Chart of Accounts (if other than SGL)				
13.	Schedule of summarized FACTS data				
14.	Organizational chart(s) of all agency departments indicating key personnel and their responsibilities				
15.	<u>Minutes of the audit committee for the period under audit.</u>				
16.	Annual Performance and Strategic Plans				
17.	Any corrective action plans related to prior year DOD IG, GAO, Defense Contract Audit Agency, internal audit, or external audit report, if any				

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L1-45

One tool to help you is the auditor's request for client information, commonly called a Prepared By Client (PBC) List. The PBC List is often provided to the auditee and identifies areas of audit focus such as required access, documentation, interviews, and/or diagrams. It also identifies dates for auditor availability. It can facilitate the audit process by ensuring coordination with those points of contact the audit team will need to meet with. Remember, it's not just so-called accounting information, since much of the originating documentation may be in non-accounting organizations. For example, PP&E should be tested for existence and completeness at the site long before the auditors arrive. It's important to get the right people/products at the right place at the right time. If you can't support the numbers before the auditors arrive, it won't happen after.

Entities need GS-510/accountants on board to speak with DFAS and sometimes even with auditors. They carry the expertise to communicate and certify as specified by law and regulation. The Defense Commissary Agency (DeCA) is an example Best Practice regarding the addition and use of the accounting series personnel. While you are at it, look for people in your organization who are good report writers.





## Audit Coordination (cont.)



### Sample PBC List

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
1.	<b>Property and Equipment Management</b>				
2.	Property and equipment lead schedule at 9/30/XX				
3.	Copy of policies and procedures related to property and equipment during FYXX				
4.	Access to property and equipment sub-ledgers, including detail of FYXX additions, disposals/sales, transfers in/out, and accumulated depreciation				
5.	<u>Detail of FYXX repair and maintenance</u>				
6.	Detail file of any construction in progress. Schedule should include all supporting documentation (engineering drawings/plans) and or contract and related contract changes, retainage, etc.				
7.	Electronic file or schedule of all capital and operating leases as of 9/30/XX. Schedule should include lease ID number, the location and description of the asset being leased, inception date, expiration date, the annual rental payment, and minimum non-cancelable lease payment.				
8.	Amortization schedule and interest paid related to capital leases				
9.	Schedule of future minimum lease payments at 9/30/XX				
10.	Access to copies of all capital and operating leases				
11.	Listing of property held for and by others, if any				

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L1-46

Coordination may even include the Agency Head to identify who can prepare the information listed. Individuals will need to consider the universe of transactions, that is, what criteria to consider when pulling the pool of documents or transactions together. Possible events may be located in non-financial systems or sub-ledgers with all transactions and require computer assistance to pull the selected universe of transaction to be audited. Source documents must support the value and explicitly identify each item.

If you absolutely cannot get certain documentation, the DoDFMR provides for some alternatives. It's important to start working these as soon as you know you are lacking. It may be possible to gain approval of certain system queries or other reports that become the new basis for future audit follow ups. Remember that systems are continually being updated so it's important to save copies of databases at specific points in time (like the end of quarter and end of year).

Finally, remember that timeliness in response to the auditors is of importance. The auditors have a limited time to conduct the required interviews. Help move the auditors from process to process. Set the tone from the beginning with a well-orchestrated entrance conference that lets them know you are prepared. Get access to external activities if required. Use the PBC List to facilitate the who, what, where, when, and how.





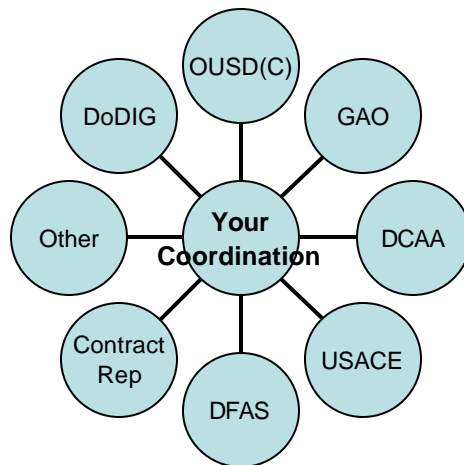
## Audit Coordination (cont.)



**Become partners with internal and external resources!**

- **FMR requires certain coordination.**
- **Follow the audit trail.**
- **Work with or establish an audit committee.**

DeCA reports that they have found it useful to use a good external auditor. Others have found success by using contractors to do inventories.



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L1-47

Often the office that maintains the supporting records for a particular financial balance is outside the control of the accounting office. For example, DFAS does not control the inventories of PP&E for USTRANSCOM components. The DoDFMR requires that when a customer outside of the control of DFAS maintains subsidiary records, DFAS must establish a schedule to reconcile the subsidiary records with the financial balances. Just because the regulation says a certain coordination must take place is not the only reason you should be examining where or with whom you coordinate. Let the audit trail lead you. That's one reason why it's important to stay partnered with such activities as the OUSD(C), GAO, DoDIG, DCAA, Corps of Engineers, DFAS, contract representatives, and others. If your activity works with or through one or more of these, it's far better to work on the same plan than to work from different agendas.


Another tool that can help is an audit committee – be sure to check the minutes too. They may have, or be able to obtain, certain resources to help you do some of the tasks you need to accomplish. Management involvement cannot be overlooked. You know that if the leadership doesn't place emphasis on something, it isn't likely to get too much attention. It's true here as well. This class is a good example of the Department's commitment to help attain an unqualified audit opinion by FY 2007. The Defense Commissary Agency (DeCA) reports they have also found it useful to use a good external auditor and some have found success by using contractors to do inventories. The main point with any use of an outside group, whether contract or not, is to partner with them. Get their buy-in to ensure your success.

Another reason for coordination is the determination of preponderant use, which will be discussed later. But where can we start?






## Audit Coordination (cont.)




### Steps to Effective Audit Management


**Exceptions**

**Unique**

**Focus**

**Scope of Audit**

**Management Review**



Do you have written authority for exceptions to policy and regulation?

Does your documentation explain everything?

Do you know what is most important?

What is being audited?

Have internal controls been reviewed?

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L1-48

Management review of the process or effective internal controls is a good place to start. They can help in preparing the PBC list as it may require higher level coordination at the beginning stages of development. You must also know the scope of the audit. There has to be focus or you're trying to be everywhere at once. You have to know what the numbers mean. It's back to supporting documentation. How can you prove what you are reporting? And finally, is there anything unique that must be verified and explained? It's better to get memorandums, or whatever is required to support your case, before the audit. Additionally, it's a must to get permission if you need an exception to the DoDFMR. One of the many tools the auditor uses is verifying compliance with regulations.

Next, let's look at some challenges you might encounter.





## Audit Coordination (cont.)



### Overcoming Challenges

- **Lead by example.**
- **Read journals and industry papers.**
- **Update policies and procedures.**



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L1-49

Someone said that one of the challenges they faced was a fear of success...without being able to sustain it! And it is true that after-the-fact we have seen audit opinions drop to lower ratings when some new event was revealed; however, that can't be the guiding light.

Challenges must be faced to succeed. For example, the challenge of going to a paperless operation. It is often difficult to maintain accountability while transitioning to a paperless operation. Some maintain hard copies of everything, including third-party documentation, for fear of not being able to find it again. The challenge seems to be how to find a happy medium that allows you to follow the laws and regulations without trying to take on everything by yourself. It takes teamwork and coordination.

Over the past several years, numerous changes have taken place that challenge even the best of us. So how can you stay in front of the flood? Lead by example. Read journals and industry papers to remain current. Review policies and procedures, and update them or refer them to the appropriate source for action.





## Audit Coordination (cont.)



### What can YOU do to help ensure proper accountability and record keeping?

- **Management involvement in the review of policies and procedures**
- **Process action teams**
- **Ensuring proper accountability and monitoring**
- **Communication/coordination**



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L1-50

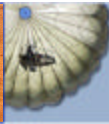
Actions that may contribute to audit deficiencies occur most often when:

- entries in documents and systems are not supported by individual assets
- when closed activities report capitalized and non-capitalized property items
- when subsidiary systems have “placeholder” acquisition costs entered (entries like \$.01 if the actual value is unknown)
- when conflicting guidance within internal policy directives exists
- when reviews of property accountability records are not conducted in a timely manner, allowing errors to go undetected and uncorrected.

So how do you help? In a word, coordination. Management needs to become involved to review policies and procedures to increase the effectiveness of guidance, establish a Process Action Team to review policies and procedures, make sure data is entered into the property accountability system to ensure that there are controls over the accuracy and completeness of acquisition costs, dates, description, and location. Many of the recommendations involve multiple organizations and coordination throughout the structure. Every person in the organization must take a personal stake in the entity's plan to have a clean audit opinion and support the consolidated DoD statements by FY 2007. It won't happen without your support and help. The bottom line is stay current and coordinate with everyone an auditor will need to speak to or collect data from.

Next we examine audit trails.





## Audit Trails



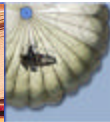
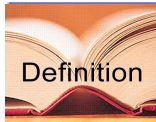
### **What is an audit trail?**

**Refers to the documents, journals, ledgers, worksheets, reports, statements, and so forth, by which an original transaction can be traced forward to a summarized total, or a summarized total can be exploded backward to the original transaction.**

Basically, an audit trail documents the processing of source transactions into feeder systems, through the accounting system, as reflected in the financial statements. But, it must be traceable. An analogy to the audit trail can be seen in the following example. If I were to ask you to give me a 24 hour head start, then follow and find me, you would have a very difficult time. Unless of course, I provide you with some directions, a map, or perhaps my destination. What could make matters just as bad is if I should provide you with the wrong map or inaccurate directions. You could be chasing me forever without finding me!

The same can be said for the balances an auditor must examine during the annual financial statements audit. They may know that a certain transaction ought to have specific documentation to support it, but if documentation is missing or inaccurate, it can lead the auditor to the wrong destination.





## Audit Trails (cont.)



**The DoDFMR requires that adequate documentation be maintained for an effective audit trail. An audit trail enables the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source.**



The DoDFMR describes it like this. I'll give you a minute to read it.

The FMR states that a key test of the adequacy of an audit trail is whether tracing the transaction forward or backward will permit verification of the amount recorded or reported. Again, it is the detailed proof that an event occurred that can be traced by someone else. Sounds simple enough! But, this is a major challenge for the department, so let's look at source documentation now.



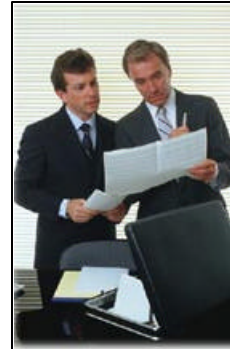


## Audit Trails (cont.)



**All PP&E transactions must be supported by source documents, including:**

- **purchases, transfers, donations, or other means of acquisition**
- **retirement or disposal transactions**
- **construction projects.**



The audit trail is established with purchases, transfers, donations, or other acquisitions effective as of the placed in service date. Retirements or disposals are effective when the PP&E leaves the owner's custody.

Proper documentation includes the physical quantity, location, and unit cost. The property records should be designed to assist making decisions related to procurement and use. This is especially important as related to potential excess PP&E that may be available for reuse, transferred to another component, or disposed of.

One example of source documentation is the DD Form 1354, Transfer and Acceptance of Military Real Property. It's used to show construction-in-progress for posting, upon completion of the project.





## Audit Trails (cont.)



**Supporting documentation must follow the PP&E when:**

- **it transfers to another activity**
- **it is traded, sold, or disposed through salvage or demolition.**

**Supporting documentation must be retained at least 6 years and 3 months; however, you should verify specific retention periods for each type of PP&E documentation you use.**



**NARA GRS: [http://www.archives.gov/records\\_management/records\\_schedules.htm](http://www.archives.gov/records_management/records_schedules.htm)**

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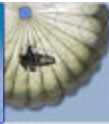
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It is important for copies of supporting documentation to accompany the General PP&E and continue to be retained in accordance with Volume 1, Chapter 9, of the DoDFMR and National Archives and Records Administration (NARA).

When disposed of through salvage or demolition, a copy of the original acquisition documentation and disposal documentation must be retained per the applicable NARA instructions.

An example might include the transfer of a ship from the Navy to the Air Force. Supporting documentation must accompany the ship so that the Air Force can properly report it on their financial statements.





## Audit Trails (cont.)



**Supporting documentation must identify and classify PP&E that was:**

- **capitalized**
- **expensed.**



**Capital leases are considered equivalent to a purchase, while operating leases cover the use of an asset for a period of time and are treated by the lessee as periodic expenses.**



PP&E that does not meet the capitalization threshold, and is therefore expensed, must still be recorded in property accountability records (or systems) for control purposes if the cost is equal to or more than \$2,500. Also, PP&E that is considered sensitive and/or subject to pilferage, regardless of the cost, must be recorded in property accountability records.

Records must document the identity and maintain accountability for capitalized additions and improvements to PP&E.

Lease improvements documentation must also provide information to identify and account for leased PP&E, no matter if it was acquired by capital lease or operating lease, or whether the value exceeds the DoD capitalization threshold. Capital leases are considered equivalent to a purchase, while operating leases cover the use of an asset for a period of time and are treated by the lessee as periodic expenses.





## Audit Trails (cont.)



**Estimates must be made if supporting written or electronic documentation is not available:**

- for the cost of the PP&E
- for the accumulated depreciation
- proportionate to the materiality and relative significance.

**Procedures for valuing PP&E, when documentation does not exist:**

- current working estimates prepared for acquisition
- appropriation or other Congressional information
- plant replacement and improvement program documentation
- estimated cost of similar assets at the time of original acquisition
- current cost of similar assets discounted for inflation.

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Estimates must be made if supporting written or electronic documentation is not available.

The method of estimation and all details are important information to support the cost estimate documentation. Acceptable procedures for valuing PP&E for which historical cost documentation does not exist include:

- current working estimates prepared for acquisition
- appropriation or other Congressional information
- plant replacement and improvement program documentation
- development of an estimate based on the cost of similar assets at the time of original acquisition
- current cost of similar assets discounted for inflation since the time of acquisition.

The effort put forth and the precision desired should be relative to the value and significance of the specific asset involved.





## Audit Trails (cont.)



### All supporting documentation will be retained:

- in accordance with the National Archives and Records Administration (NARA) General Records Schedule (GRS) and agency-specific instructions
- as original documents and/or hard or electronic copies in a readily available location.



### Typical kinds of documentation:

- contracts and invoices
- DD Form 1354, Transfer and Acceptance of Military Real Property
- ENG Form 3013, Work Order/Completion Record
- work orders
- other third-party documentation
- for all DoD-owned PP&E.

The NARA procedures are briefly discussed in Volume 1, Chapter 9, of the DoDFMR. The DoDFMR also contains a link to the General Records Schedule (GRS). In summary, it states that all supporting documentation should be retained in a readily available location. This means you already have to know what the auditors would need to see. Supporting documentation is also required to be retained for DoD-owned PP&E held by others and that of others held by DoD through seizure, forfeiture, loss, or abandonment. Records should allow validation of the acquisition cost, acquisition date, and any improvement costs and dates. Typical kinds of documentation include:

- contracts
- invoices
- DD Form 1354, Transfer and Acceptance of Military Real Property
- ENG Form 3013, Work Order/Completion Record
- work orders
- other third-party documentation (generated independently of the entity in possession of the property).



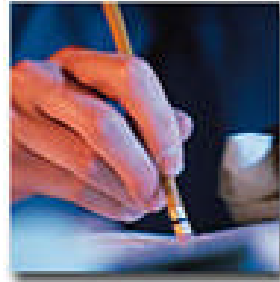


## Audit Trails (cont.)



### Adjustments to Records:

- Memorandums for Record
- Journal Vouchers (JVs)
- other adjusting documents



**It is important to remember that errors are more prone in non-routine transactions, so pay particular attention when making adjustments.**

There are several things to keep in mind anytime you need to make adjustments to a transaction. You should remember the consequences of that adjustment by providing adequate support to the adjustment. What is needed is written documentation that is sufficiently detailed to provide an audit trail to the source that requires the adjustment. This documentation ought to include the rationale and justification for the adjustment, detailed numbers and dollar amounts of errors or conditions that are related to the transaction or record that is proposed for adjustment, the date of the adjustment, and the name and position of the individual approving the adjustment.

It is important to remember that errors are more likely in non-routine transactions, so pay particular attention when making adjustments.

Next we examine internal controls that can help you minimize errors.





## Internal Controls



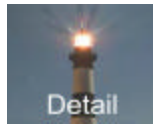
### The law and its implementation:

- **Federal Manager's Financial Integrity Act (FMFIA)**
- **OMB Circular No. A-123**
- **GAO Standards for Internal Control in the Federal Government**
- **Management Control Program Procedures, DoDI 5010.40.**
- **Internal Management Control Program, DoDD 5010.38**

Congress saw the lack and inconsistency of good internal controls that existed within the government and determined to correct the issue. You can see the interest of Congress simply by looking at the number of laws enacted that affect internal controls. We will examine a few of these in this part of the lesson.

The FMFIA of 1982 amended the Accounting and Auditing Act of 1950 to require federal agencies to establish internal control programs. As part of the implementation, the OMB distributed Circular A-123 to provide specific requirements for assessing and reporting on controls. The GAO was tasked under the FMFIA to create the Standards for Internal Control in the Federal Government in order to provide the overall framework for establishing and maintaining internal control. Within the DoD, DoD Instruction 5010.40, DoD Management Control Program Procedures, implements the policy, assigns responsibilities, and prescribes procedures defined in DoD Directive 5010.38, Internal Management Control Program (MCP).





## Internal Controls (cont.)



### **FMFIA:**

- **in compliance with law**
- **assets are safeguarded**
- **revenues and expenditures recorded**
- **use consistent with mission**
- **minimal potential for loss.**



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Although internal controls have been part of management for many years, the formal program established in the Department came from the FMFIA. It requires agencies to establish internal controls that reasonably ensure that:

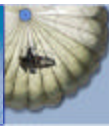
- obligations and costs comply with applicable law
- assets are safeguarded against waste, loss, unauthorized use, or misappropriation
- revenues and expenditures are properly recorded and accounted for.

Proper stewardship is a responsibility of every individual, whether manager or staff, and the keys to good stewardship are inherent in understanding and fulfilling the law. This means every DoD employee has a responsibility to ensure that government resources are used:

- consistent with the agency mission
- in compliance with applicable laws, directives, and instructions
- with minimal potential for waste, fraud, and mismanagement.

The FMFIA also requires, as part of the annually audited financial statements, that a statement be included regarding the conformance of the agency's accounting system with applicable standards.





## Internal Controls (cont.)



### **GAO fundamental concepts:**

- **continuous built-in action**
- **staff involvement**
- **reasonable assurance, not absolute assurance.**

Internal control provides reasonable assurance that the Department is achieving the desired results through effective stewardship of public resources. It is based on what the GAO terms fundamental concepts. That is, internal control is not a single, isolated event, but rather a continuous series of actions and activities that are part of the entire day-to-day operation. People are at the center of effective internal control. While management sets the objectives, the staff makes it happen. And finally, cost and benefit must be judged when designing and implementing internal control. The cost to provide absolute assurance is simply prohibitive in most instances. Additionally, there are factors outside the control or influence of management that can affect the organization's ability to meet its goals. Even things like human mistakes, judgment errors, and acts of collusion can affect meeting objectives.





## Internal Controls (cont.)



### **Activities for which internal controls are designed:**

- actual performance reviews
- effective management of the workforce
- controls over information processing
- physical control over certain assets (cash and pilferable inventory)
- establishment and periodic review of performance measures
- segregation of duties
- proper execution of transactions based on proper authority
- accurate and timely recording of transactions or events
- limited access and strict accountability for certain resources and records
- clear documentation for all transactions and significant events that is readily available for review.

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Internal control activities are the policies, procedures, techniques, and mechanisms that help ensure that management's directives to mitigate the previously identified risks are carried out. Control activities are an integral part of planning, implementing, and reviewing. They are essential for proper stewardship and accountability and for achieving effective and efficient results. Control activities should occur at all levels of an entity and include a whole range of activities, such as approvals, authorizations, verifications, reconciliations, performance reviews, security, and the creation and maintenance of appropriate documentation. Some examples include:

- actual performance reviews, at the top level and at the functional levels
- effective management of the workforce
- controls over information processing (checks of data entered, comparing totals with control accounts, control of access to data, files, and programs)
- physical control over certain assets (cash, pilferable inventory)
- establishment and periodic review of performance measures
- segregation of duties
- proper execution of transactions based on proper authority
- accurate and timely recording of transactions or events
- limited access and strict accountability for certain resources and records
- clear documentation for all transactions and significant events that is readily available for review.



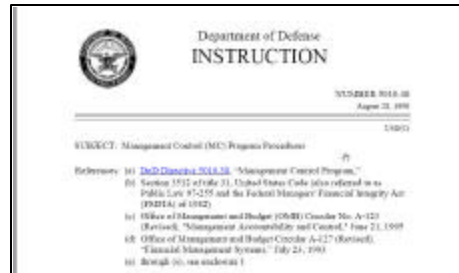


## Internal Controls (cont.)



### Management Control Program Procedures, DoDI 5010.40:

- **develop a management control program**
- **statement of assurance.**



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L1-63

DoDI 5010.40, Management Control Program Procedures, implements the policy, assigns responsibilities, and prescribes procedures found in the DoD Directive 5010.38, Management Control Program, FMFIA, and OMB Circular A-123. DoD Directive 5010.38 states that the Department will establish a management control program and take action to identify and correct ineffective management controls, and establish new ones when needed. The OUSD(C) is charged to monitor compliance, while other Under Secretaries and Assistant Secretaries of Defense are charged to identify systemic management control weaknesses in their functional areas that should be reported, and to review the actions reported by DoD components.

The heads of DoD components are also charged to develop and maintain their management control programs to conclude with the reporting of management's opinion about the effectiveness of its management controls. This includes such things as assigning responsibilities, developing internal reporting and tracking abilities, ensuring periodic evaluations (or ongoing monitoring as just discussed in the GAO standards), and maintaining appropriate documentation.

What are some of your internal controls?

DoD components should submit their annual statement of assurance based on a general assessment of the effectiveness of their management controls. The statement will also include material weaknesses and the correction plan for them. The statement will be signed by the head of the DoD component and submitted to the Secretary of Defense each year.





## Internal Controls (cont.)



### Management control weaknesses should be:

- identified
- reported
- corrected.



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Management control weaknesses should be:

- identified through such activities as audits, investigations, management assessments, credible information from nongovernmental sources, staff meetings, and management control evaluations
- reported if they are deemed material.

A material weakness must satisfy some conditions:

- it results from management controls that are not in place, not used, or not adequate
- it must be reportable to the next higher level of management
- it must be corrected by DoD component managers in a timely and effective manner.

Tracking should be equal to severity of the weakness. A determination that a material weakness has been corrected should only be done when sufficient actions have occurred and achieve the desired results. The last milestone in each corrective plan should include correction validation.





## Internal Controls (cont.)



### GAO/PCIE - FAM:

- **Volume 1, Methodology, Sections 100-500**
- **Volume 2, Tools, Sections 600-1000 and Checklist**



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The GAO/PCIE FAM comes in two parts containing the methodology and tools that should be referenced when conducting an audit. It is one of many tools an auditor will use to assess your internal controls, and you should know how to use it as well.

One of the more important sections you should become familiar with is Section 300. It provides that a cycle memorandum or flow chart should be designed to document a complete understanding of the internal control structure as it relates to a specific cycle in the financial accounting process.

The cycle memorandum should:

- identify the cycle transactions, each significant accounting application, and each significant financial management system included in the cycle
- describe interfaces with other cycles
- identify financial statements line items and general ledger accounts included in the cycle
- describe the operating policies and procedures relating to the processing of cycle transactions
- identify major internal controls.

Section 700 provides a tool to help auditors perform a financial statements audit regarding internal controls, and section 900 contains additional testing tools regarding substantive testing, which may be applicable to internal controls as well as other areas.

Next we discuss the Federal Information System Controls Audit Manual (FISCAM).





## Internal Controls (cont.)



### **GAO Federal Information System Controls Audit Manual (FISCAM)**

**The GAO FISCAM discusses the control objectives that auditors should consider when assessing computer-related controls and it provides examples of control techniques commonly used at federal agencies along with suggested audit procedures.**

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Federal agencies rely on computer-based information systems such as STANFINS, SOMARDS, and STARS/FL to carry out agency programs, manage federal resources, and report program costs and benefits.

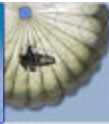
The GAO FISCAM is designed for information systems auditors and financial auditors who conduct audits of computer-based systems. This manual is a companion to GAO's FAM and discusses the control objectives that auditors should consider when assessing computer-related controls. It provides examples of control techniques commonly used at federal agencies along with suggested audit procedures.

There is a general methodology that is used by auditors to assess computer-related controls; general controls at the entity or installation level; general controls as they are applied to the application being examined, such as a payroll system or a loan accounting system; and application controls, which are the controls over input, processing, and output of data associated with individual applications.

Examples of primary objectives for general controls are to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations in case of unexpected interruptions, such as power loss. This manual can be used by management as a tool to assess the internal controls of your computer-based information system.

Let's discuss the Statements on Auditing Standards 70 and 88.





## Internal Controls (cont.)



### **AICPA Statements on Auditing Standards (SAS)**

- **SAS 70, Service Organizations**
- **SAS 88, Consistency of Application of Generally Accepted Accounting Principles**

**<http://www.aicpa.org/index.html>**

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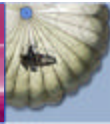
The American Institute of Certified Public Accountants (AICPA) published SAS 70 and 88, which provide information on standards for service organizations and the consistency of GAAP. SAS 70, Service Organizations, provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions. The SAS also provides guidance when an entity obtains services from another organization that are part of its information system organization. Additional information is also provided in areas such as internal controls, audit evidence, planning the audit, assessing control risks, substantive audit procedures, and reports on controls placed in operation.

SAS 88, Consistency of Application of Generally Accepted Accounting Principles, provides guidance on the second standard of reporting, which is the consistency standard. The objective of the consistency standard is to ensure that if comparability of financial statements between periods has been materially affected by changes in accounting principles, there is appropriate reporting by the auditor regarding the changes.

A change in accounting principle results from adoption of a GAAP different from the one used previously for reporting purposes (for example, if the entity changed from using the straight-line method of depreciation to the declining balance method of depreciation).

We have reached the end of the lesson, so let's summarize what we've learned.





## Lesson Summary



- **FASAB Standards or SFFAS**
- **Financial management systems**
- **Laws and regulations**
- **Audit coordination and audit trails**
- **Internal controls**

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FASAB standards include the SFFAS, which are designed to implement the GAAP. They lend additional credibility to the audited financial statements. The SFFAS play a major role in fulfilling the government's duty to be publicly accountable.

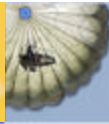
We discussed several organizations leading the way to improve the Department's financial management and reporting systems. Among them were the Business Enterprise Architecture (BEA) and the Business Management Modernization Program (BMMP), which are transforming the Department's operations to enhance military readiness. We also discussed the JFMIP, which consists of members from the Treasury, GAO, OMB, and OPM. The JFMIP's certification of COTS software has been a positive assurance for government and vendors alike.

Congress has continually provided clarification to their intent through such laws as the FMFIA, CIOA, GPRA, and GMRA. The bottom line is the importance of accountability, through systems, people, and practices.

Coordination for an audit should be ongoing, not just a last-minute effort. We looked at the PBC list and discussed the necessity of making contacts internally and externally to your organization. The definition of an audit trail was provided, highlighting the need to be reproducible backward and forward (up and down). We talked about various types of supporting documentation and records retention requirements (NARA). The capitalization threshold was reviewed as was the accountability threshold.

Internal controls should be like the air we breathe: you know it's there and you can't live without it, but it doesn't get in the way of doing your work. As the Department continues to evolve, it becomes ever more important for internal controls to be built in to systems and processes. But just having a policy on the shelf does little good unless it is read and implemented.





## References



**FASAB or SFFAS:** <http://www.fasab.gov/>

**DoDFMR:** <http://www.dod.mil/comptroller/fmr/>

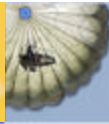
**BMMP:**  
<http://www.dod.mil/comptroller/bmmp/pages/index.html>

**NARA GRS:**  
[http://www.archives.gov/records\\_management/records\\_schedules.html](http://www.archives.gov/records_management/records_schedules.html)

**OMB Circulars:**  
<http://www.whitehouse.gov/omb/circulars/index.html>

These slides list references available for additional information.





## References (cont.)



**CFOC:** <http://www.cfoc.gov/>

**JFMIP:** <http://www.jfmip.gov>

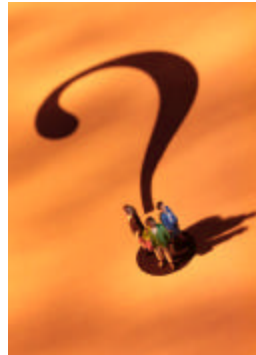
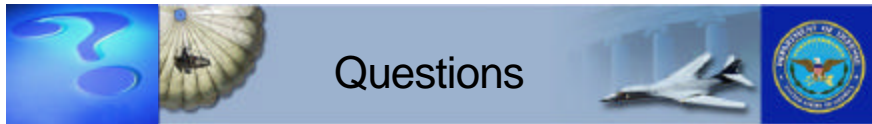
**FAM:** <http://www.gao.gov/special.pubs/01765G/>

**DoD Instruction 5010.40:**  
[http://www.dtic.mil/whs/directives/  
corres/pdf/i501040\\_082896/i501040p.pdf](http://www.dtic.mil/whs/directives/corres/pdf/i501040_082896/i501040p.pdf)

**DoD Directive 5010.38:**  
[http://www.odedodea.edu/foia/iod/pdf/d5010\\_38.pdf](http://www.odedodea.edu/foia/iod/pdf/d5010_38.pdf)

**PMA:** [http://www.whitehouse.gov/omb/budintegration/  
pma\\_index.html](http://www.whitehouse.gov/omb/budintegration/pma_index.html)



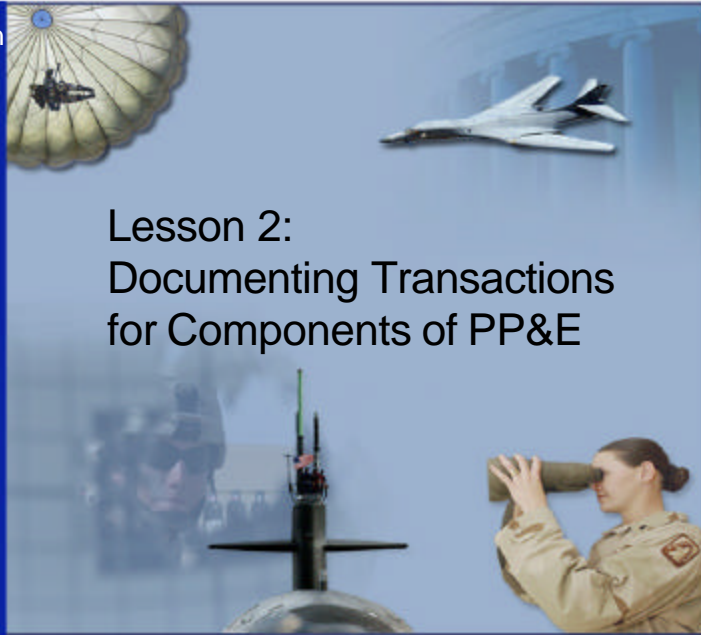




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Documentation  
for Audits of  
Property,  
Plant, and  
Equipment



## Lesson 2: Documenting Transactions for Components of PP&E

In this lesson, we are going to discuss General PP&E and how the lack of proper source documentation leads to audit deficiencies.

Both of these subjects are important to understand since they can contribute to getting less than an unqualified audit opinion.

Let's discuss the lesson objectives.





## Lesson Objectives



**Upon successful completion of this lesson, you will be able to:**

- **discuss the general characteristics of property, plant, and equipment (PP&E)**
- **explain how the lack of source documentation contributes to audit deficiencies.**

In this lesson, we discuss the different types of general PP&E and their characteristics. We talk about the guidance used to identify the different assets, how they are accounted for, and the methods used to capitalize and depreciate them.

We then discuss different types of documentation and the procedures for retention of financial and other types of records within the DoD. The different categories of records are discussed, and how they are maintained and then entered into the proper accounting and/or reporting systems. These records are important for you to understand since they are required to support transactions that are recorded in the different systems.

Let's discuss the lesson topics.





## Lesson Topics



**This lesson contains the following topics:**

- **General Property, Plant, and Equipment (PP&E)**
- **Documentation.**

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L2-3

This lesson defines the three categories of PP&E. They are General PP&E, Heritage Assets, and Stewardship Land.

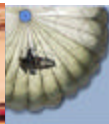
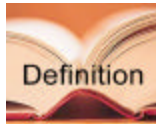
We discuss how the PP&E was acquired, how it is capitalized, and how its cost is estimated and eventually accounted for.

Once items are acquired, we then discuss the different types of supporting documentation that are used.

If these transactions are properly identified with the correct supporting documentation, they can be posted to the correct accounts and properly depreciated, and therefore assist the department in obtaining a clean audit statement. Department personnel at all levels should do their part to ensure that an unqualified audit opinion is obtained by FY 2007.

Let's discuss General PP&E.





## General PP&E (cont.)



### Types of General PP&E:

- real property
  - lands and improvements
  - buildings and structures
  - equipment affixed
- military equipment
  - weapons systems
  - support PP&E
  - vessels in preservation status
- capital leases
- leasehold improvements
- asset owned in possession of others
- land in connection with PP&E construction
- land rights

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Documentation for Audits of PP&E

L2-4

The DoDFMR, Volume 4, Chapter 6, Property, Plant, and Equipment, outlines the accounting standards and policy for PP&E. DoDFMR, Volume 6B, Chapter 11, Required Supplementary Stewardship Information Reporting, provides information on the reclassification of the assets from National Defense PP&E to General PP&E. This change is identified in SFFAS No. 23 and provides information on the implementation guidance for the initial capitalization for the assets considered National Defense PP&E.

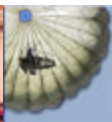
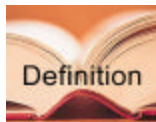
Types of General PP&E include real property, military equipment, capital leases, leasehold improvements, assets owned by an entity in the possession of others, and land (other than Stewardship Land) in connection with the construction of General PP&E and land rights.

Real property consists of lands and improvements to land; buildings and structures, including improvements and additions; and utilities. It includes equipment affixed and built into a facility as an integral part of the facility (such as heating systems), but not movable equipment (such as plant equipment). In many instances, this term is synonymous with “real estate.”

Military equipment consists of components of weapons systems and support PP&E used by Military Departments in the performance of military missions and vessels held in a preservation status by the Maritime Administration’s National Defense Reserve Fleet. Inventories of General PP&E must be performed periodically, as outlined in paragraph 060107 of the DoDFMR, Volume 4, Chapter 6, depending on the type of PP&E. The inventories are reconciled to the property accountability records and/or systems. Some of the terms associated with General PP&E, such as capitalization, preponderant use, capital improvements, and depreciation, will be discussed in the following slides.

Let’s discuss the term capitalization.





## General PP&E (cont.)



**General PP&E are tangible assets such as real property, capital leases, military equipment, and leasehold improvements that meet the following criteria:**

- **useful life of two years or more**
- **not intended for sale**
- **built or acquired to be used by an entity**
- **has an acquisition cost that equals or exceeds the DoD capitalization threshold (\$100,000.00).**

**To capitalize is to classify a cost as a long-term investment, rather than charging it to current operations.**

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Documentation for Audits of PP&E

L2-5

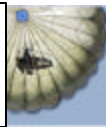
General PP&E consists of tangible assets that meet the requirements in the DoDFMR to be capitalized, recorded in the property accountability system, and depreciated. When you capitalize an item, you classify it as a long-term investment, determine a useful life for the asset, and record the item in a property management system. After General PP&E is acquired, the cost of the asset plus any costs to bring it into operable condition is capitalized if the cost equals or exceeds the Department's capitalization threshold (currently \$100,000.00 for both General and Working Capital Funds) and the asset has a useful life of two or more years. During an audit, the auditors look for documentation such as purchase invoices, procurement contracts, DD Form 1354, Transfer and Acceptance of Military Real Property, construction contracts, or work orders.

The departments are required to have a property management system along with a financial reporting system. Property is received by a department and captured in the property management system. The property management system should distinguish between capitalized property and expensed property. Property management systems classify PP&E by Standard General Accounts such as buildings, land, equipment, and assets under capital lease. The property management system should capture the useful life, depreciation, and salvage or residual value for each asset or group of assets, when applicable. This property management system should be capable of interfacing with other financial and/or mixed systems. For example, a transaction is input into your financial system to record the receipt of the asset and to establish an accounts payable. In addition, there is a transaction input into your property management system to record the PP&E and establish the depreciation expense, based on the useful life of the asset.

When a Balance Sheet is prepared, the information from the financial system along with the associated depreciation (on an annual basis) from the property management system updates the appropriate PP&E account on your financial statements. Depreciation is determined using the appropriate table from the DoDFMR, Volume 6, Chapter 4.

Let's continue with some examples of capitalization.





## General PP&E (cont.)



### Examples of capitalization:

- **General PP&E bulk purchases**
  - for example, 50 vehicles costing \$10,000.00 each, total cost exceeds capitalization threshold, but total is expensed since each item is less than \$100,000.00
- **Items \$100,000.00 or more for General and Working Capital Funds**
  - for example, 50 vehicles costing \$100,000.00 each, total cost per asset equals or exceeds the threshold, therefore, the items are capitalized

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Documentation for Audits of PP&E

L2-6

General PP&E purchased in bulk that individually meets the capitalization threshold is capitalized and recorded in a property accountability system that is capable of computing depreciation.

There should be adequate documentation such as purchase invoices, sales and procurement contracts, ENG Form 3013, Work Order/Completion Report, and construction contracts to support the acquisition of General PP&E. The items are recorded in a property accountability and/or accounting system and assigned a dollar value.

For example, if you had a bulk purchase of 50 vehicles costing \$10,000.00 each, the total cost is \$500,000.00. The entire amount would be expensed.

However, if you had a bulk purchase of 50 vehicles costing \$100,000.00 each, the total cost is \$5 million. Since each of the items cost \$100,000.00, each of the items would be capitalized and depreciated.

Let's discuss the guidance for preponderant use.





## General PP&E (cont.)



**DoDFMR, Volume 4, Chapter 6, provides guidance for recognition of acquired assets.**

### **What is preponderant use?**

**An example might include a commissary on an Air Force base. The DeCA owns the CIP until placed in service date.**

**The Air Force reports the accountability of the property while the DeCA reports the financial accountability.**

**DD Form 1144 specifies what support the Defense agency receives such as reimbursement, billing, and financial reporting requirements.**

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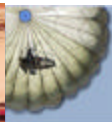
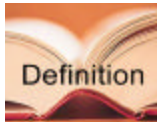
These are two methods that could be used to document which entity recognizes the assets for accounting and reporting purposes. The DoDFMR, Volume 4, Chapter 6, Property, Plant, and Equipment, provides the guidance for recognition of acquired assets for accounting and reporting purposes. In all instances, the asset is recognized by the component that acquires the asset. There is an exception based on the concept of preponderant use, which will be explained.

It is important to understand this concept of preponderant use. Assets are recognized properly and are reported only once on financial statements. Therefore, the Defense agencies should coordinate with military departments to ensure completeness in reporting assets and avoid duplicate reporting of them on financial statements. The Defense agencies that produce financial statements and/or are included in the Department's consolidated financial statements generally must recognize and report the facilities used in their operations. In all instances, the facilities used by the Defense agencies are owned by, or titled to, the Military departments.

One method of establishing responsibility, especially for reporting purposes, is through a DD Form 1144, Interservice Support Agreement. This form identifies the supplying activity and the receiving activity. A DD Form 1144 specifies what support the Defense agency receives including billing, reimbursements, and specific provisions such as reporting on their financial statements. In addition, Memorandums of Agreement (MOAs) and Memorandums of Understanding (MOUs) establish command-to-command relationships, statements of fact, intentions, procedures, and matters of coordination agreed on by the signatories. MOAs and MOUs are not substitutes for formal interservice, intraservice, interdepartmental, or interagency support agreements.

Let's discuss what preponderant use is.





## General PP&E (cont.)



**Rules used to identify who recognizes the asset for accounting and reporting purposes:**

- **the asset must embody a probable future benefit that will contribute to the activity's operations**
- **the activity that reports the asset must be able to obtain the benefit and control access to the benefit inherent to the asset**
- **transaction or event already occurred**
- **only report cost of assets material to preponderant user.**

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The basic question is, who recognizes an asset for accounting and reporting purposes? In most instances, legal ownership usually, but not always, is the determining factor that department components use to recognize an asset. For example, buildings used by a Working Capital Fund (WCF) may not have been constructed with Working Capital Funds. However, the buildings should be capitalized and depreciated by the WCF and reported by them on their financial statements.

There are four criteria when determining what component must recognize the PP&E.

- The asset must embody a probable future benefit that will contribute to the component's operations.
- The component that reports the asset must be able to obtain the benefit and control access to the benefit inherent to the asset.
- The transaction or event giving a component the right to, and control over, the benefit of an asset must have already occurred.
- The component shall only report predominately used assets owned by other components when the cost of those assets, taken as a whole, are material to the predominate user's financial statements.

Let's look at some examples of preponderant use.





## General PP&E (cont.)



### Examples of preponderant use:

- **Military departments - General Fund**
- **Defense Agencies - General Fund**
- **Working Capital Funds.**



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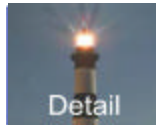
L2-9

These are three examples of preponderant use.

- The Air Force is a tenant in a building on an Army installation. The Army should report the asset on their financial statements, not the Air Force. This policy recognizes that the military departments routinely use each other's facilities in the normal course of carrying out their missions, and the net effect of this cross-use of facilities is not material to the military departments' financial statements.
- Defense agencies that produce financial statements and/or are included in the DoD consolidated financial statements, must recognize and report the facilities used in their operations. All facilities used by the Defense agencies are owned by the military departments. These facilities are material to the Defense agencies' financial statements and shall be reported on the annual financial statements of the Defense agencies' and excluded from the financial statements of the military departments. Coordination between the Defense agencies and the military departments shall be done to ensure completeness and avoid duplicate reporting of assets.
- If a WCF activity is the preponderant user of a facility, the activity shall report and depreciate the facility on their financial statements.

The basic idea of preponderant use is to recognize the assets and determine on what activity's financial statement they are reported. Let's look at the rule for preponderant use and capital improvements.





## General PP&E (cont.)



### **Preponderant use and capital improvements rules**

- **If a WCF funds capital improvements, this activity shall report and depreciate the improvements on their financial statements.**
- **If a Defense agency occupying a facility with a military department makes capital improvements, the Defense agency reports the depreciation and improvements on their financial statements.**
- **Supporting documentation must be available to support the financial statements reporting improvements.**
- **Maintenance or repair work is not considered a capital improvement, even if the cost equals or exceeds the capitalization threshold, this work is expensed.**

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If a WCF funds capital improvements, it shall report and depreciate the improvements on their annual financial statements whether or not the activity is the preponderant user of the facility improved.

If a Defense agency occupies a facility with a military department and makes a capital improvement, the Defense agency shall record the capital improvement in the applicable property records. The Defense agency should report the depreciation and capital improvements on its financial statements.

Supporting documentation such as work orders, construction contracts, and purchase invoices should be available to support the financial statements' reporting of capital improvements made.

When maintenance or repair work is performed, it is not considered capital improvements, regardless of whether the cost equals or exceeds the DoD capitalization threshold. Maintenance or repair work is recorded as an expense.

It is important to understand these rules so assets and improvements are properly recorded on the appropriate entity's financial statement.

Let's move on and discuss some exceptions to preponderant use.





## General PP&E (cont.)



### Exceptions to preponderant use rule

- **If another federal agency is a tenant on an Army installation, the Army reports the building on their financial statement.**
- **When DoD medical facilities are located on military installations, the military department that owns the installation reports the facility on their financial statement.**

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L2-11

There are some exceptions to the preponderant use of assets. When another federal agency is a tenant on an installation, and it is the predominant user of the building, the installation should report the building on its financial statement.

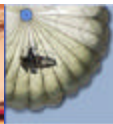
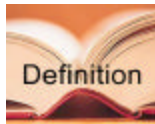
In addition, the preponderant policy does not apply to DoD medical facilities. Most of the funding for medical activities is centralized through the Office of the Secretary of Defense (Health Affairs) (OUSD (HA)); the OUSD (HA) does not exercise command and control authority over medical activities.

Different types of medical facilities are located at military installations or are otherwise under the command and control of one of the military departments. The medical mission is to serve the personnel and families at or near the military installation.

Therefore, the installation is the preponderant user of the facility, and the medical facility, and all of the medical General PP&E, shall be reported on the annual financial statement of the military department that owns the installation upon which the medical facility resides.

Let's move on and discuss capital improvements.





## General PP&E (cont.)



**Capital improvements increase useful life, efficiency, capacity, or modify functionality.**

**Repairs and maintenance costs are not considered capital improvements.**



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You were introduced to capital improvements in Lesson 1; now we get into more detail.

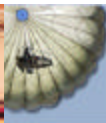
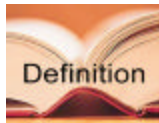
When General PP&E is improved, the cost to improve the asset is capitalized (if the improvement equals or exceeds the DoD capitalization threshold, regardless of the funding source) when the cost of the improvement increases the asset's capacity, size, efficiency, or useful life. The improvements are capitalized and depreciated separately from the General PP&E asset improved.

If improvements are made that do not increase an asset's capacity, size, efficiency, or useful life, regardless of the cost of improvement, the cost is expensed. Repair and maintenance (to maintain equipment or real property) costs are not considered capital improvements regardless of the cost. If a roof or a heating system is replaced due to the failing of an existing asset, these replacements are classified as repairs and are expensed.

In most instances, repair costs are expensed. However, when repaired by replacement, the repair may be expensed or capitalized. Capital improvements to fences, roads, bridges, sewers, and utilities are depreciated in accordance with the requirements of the DoDFMR.

Now that we have discussed the three categories of General PP&E, capitalization, preponderant use, and capital improvement, let's discuss a method used to depreciate these assets.





## General PP&E (cont.)



**Depreciation is the allocation of acquisition cost over the period of time the asset provides benefits. This is due to the matching principle of matching expenses to benefits.**

**The straight-line method of depreciation is used. For example, if the asset cost \$100,000.00 and has a useful life of 10 years, you would divide \$100,000.00 by 10 years and record an annual depreciation amount of \$10,000.00. There is no tax advantage as in the private industry for the government to use accelerated depreciation.**

General PP&E assets are those that have a cost that equals or exceeds the DoD capitalization threshold of \$100,000.00 and have a useful life of two or more years. The asset is recorded at the acquisition cost plus any ancillary cost such as handling, installation, or set-up costs.

Depreciation is the allocation of acquisition cost over the period of time the asset provides benefits. This is due to the matching principle of matching expenses to benefits.

The straight-line method of depreciation is used to depreciate General PP&E. For example, if the asset cost \$100,000.00 and has a useful life of 10 years, you would divide \$100,000.00 by 10 years and record an annual depreciation amount of \$10,000.00. There is no tax advantage as in the private industry for the government to use accelerated depreciation.

We discussed the straight-line depreciation. Now let's look at the guidance in the DoDFMR and determine the recovery period based on the type of asset being depreciated.





## General PP&E (cont.)



DoD RECOVERY PERIODS FOR DEPRECIABLE  
GENERAL PP&E ASSETS  
(Excludes National Defense PP&E and Heritage Assets)

Description of General PP&E Assets	Recovery Period
General Purpose Vehicles (Includes Heavy Duty Trucks and Buses); ADP Systems and Hardware (Computers and Peripherals); High Tech Medical Equipment; Equipment used in Research, Development, Test and Evaluation (RDT&E); Radio and Television Broadcasting Equipment; and Software	5 Years*
Improvements to 5-Year Recovery Period Property (Personal Property)	
All Other Equipment, Machinery and Software**	10 Years
Improvements to 20-Year Recovery Period Property	
Vessels, Tugs, Barges and Similar Water Transportation Equipment (Non-National Defense PP&E vessels/ships)	
Steam (12.5K pounds per hour or more) and Electric Generation Equipment (500 Kilowatt or more), Sewers and Other Utilities (including such things as fiber optic cable)	20 Years
Fences, Roads, Bridges, Towers, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities and Other Real Property Structures.	
Improvements to 40-Year Recovery Period Property	
Buildings, Hangers, Warehouses, Fuel Storage Buildings, Air Traffic Control Towers, and Other Real Property Buildings	40 Years
Improvements to Leased Buildings and Other Real Property (Leasehold Improvements)	Remainder of Lease Period or 20 Years Whichever is Less
Land Rights of Limited Duration	Over the Specified Duration
TABLE 6-7	

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L2-14

Table 6-7, DoDFMR, Volume 4, Chapter 6, Property, Plant, and Equipment, provides a description of General PP&E assets and their recovery period.

DoDI 4165.14 is currently being updated and will be accepted by the DoD. The useful life of 40/20 will change when the publication is updated. A salvage or residual value is determined based on the type of asset. In most cases, personal property like ADP systems and hardware (computers and peripherals) and equipment do not have a salvage value. When computing depreciation, real property assets such as buildings, facilities, and structures do not have salvage value.

The depreciation of General PP&E is recognized as an expense on the annual Statement of Cost.

If General PP&E is transferred from one Department component or federal agency to another, the gaining component should have all of the supporting documentation for the original cost; cost of improvements; date the asset was purchased, constructed, or acquired; estimated useful life; amount of accumulated depreciation; and condition of the asset. Estimates may be necessary and must be documented if the information is not available.

We have discussed what depreciation is and the associated recovery period based on the type of asset. Now let's discuss the different categories of land.





## General PP&E (cont.)



### Three categories of land:

- **Stewardship Land**
- **Land**
- **Land Rights**



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Basically, there are three categories of land: Stewardship Land, Land (other than Stewardship Land that has an identifiable cost and was acquired for, or in connection with the construction of General PP&E), and Land Rights.

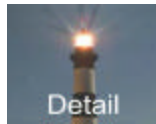
When land is acquired, it is recorded in the Land and Land Rights Account. If the acquisition cost cannot be determined, the estimated fair market value is used. A fair market value is obtained by a person outside of the DoD. A certified real estate appraiser would appraise the land based on a recent comparable sale of land in the area. For accounting purposes, land is considered a non-wasting asset and not subject to depreciation.

For the entity to maintain effective control of land or other General PP&E with DoD contractors, the DoD components must record detailed information on property provided to contractors in property management systems. Contractors report all property in their possession on a DD Form 1662 to the entity on an annual basis. More information is provided later in the lesson on this form.

There are different rules for each of the land categories. You need to understand the different types for accounting and reporting purposes.

Let's talk about Stewardship Land.





## General PP&E (cont.)



### Stewardship Land

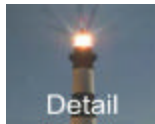
- is not acquired for, or in connection, with General PP&E
- is not subject to depreciation
- is inventoried at least every five years
- is reported on supplementary stewardship information on annual financial statements of the Department
- is reported in terms of acres instead of cost or fair market value
- is documented by contracts, purchase orders, or eminent domain.

Land provided to the DoD from public domain, or at no-cost, not used in a General PP&E context is classified as Stewardship Land. It is not subject to depreciation and is inventoried at least every five years. Stewardship Land is reported as supplementary stewardship information accompanying the annual financial statements of the Department component responsible for such land. It is reported in terms of physical units (acres), rather than cost or fair value.

Stewardship Land, public domain or no-cost land, used in a General PP&E context is not reported as General PP&E. In addition, land standing idle and not used to fulfill mission responsibilities is considered Stewardship Land.

We have discussed Stewardship Land; let's talk about the other categories of Land, and Land Rights.





## General PP&E (cont.)



**Land acquired for, or in connection with, other General PP&E shall be included in General PP&E and is:**

- **not subject to depreciation**
- **inventoried at least every five years**
- **excluded as land includes mineral deposits, petroleum, and timber**
- **specifically acquired for, or in connection, with the construction of General PP&E**
- **documented by purchase orders, contracts, or lease agreements.**

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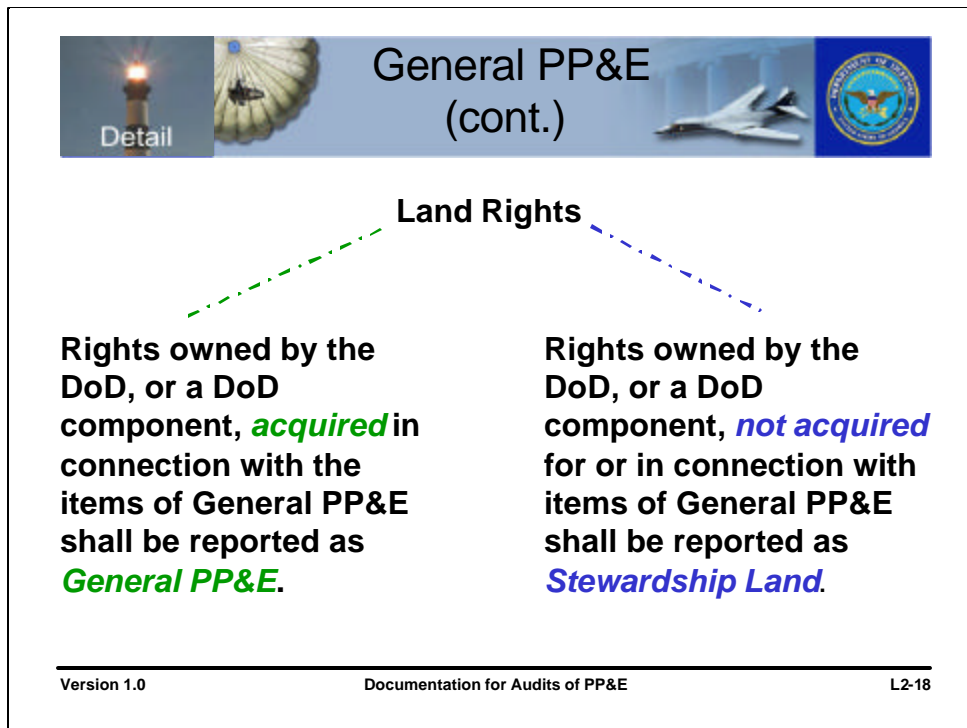
For the purpose of accounting, this category Land is considered a non-wasting asset, not subject to depreciation, and inventoried at least every five years. It is defined as the solid part of the earth surface. Some exclusions from this definition include materials beneath the surface (such as mineral deposits and petroleum) and the space above the surface (such as timber). The materials excluded are addressed separately for accounting and reporting purposes.

This is land (other than Stewardship Land) with an identifiable cost, specifically acquired for, or in connection with, the construction of General PP&E. When land is purchased, the purchase price also includes any broker's fee, commission, fees for examining and recording the title, surveying costs, and any razing and removal costs (less salvage proceeds) of structures on the land. There shall be supporting documentation with an assigned dollar amount to record the transaction in a property accountability and/or accounting system.

If land and a building are purchased together, the depreciation is based on the total purchase cost less the actual or estimated cost of the land.

We have discussed Stewardship Land and Land. Now let's discuss the last category Land Rights.



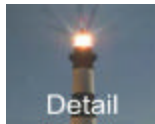


Examples of land rights are interests and privileges held by the DoD, or Department component, in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights of way, mineral rights, and other like interests in land.

There are important differences to know especially for accounting and reporting purposes. The land rights for a specified purpose are amortized (depreciated) over that period of time. The capitalization amount and the associated accumulated depreciation and depreciation expense are reflected in the financial statements.

We have discussed the three different categories of land. Now let's discuss buildings, structures, and facilities.





## General PP&E (cont.)



**General PP&E includes buildings, other structures, and facilities included on Note 10, General PP&E, Net.**

- **Line B provides a Net Book Value of Buildings, Structures, and Facilities.**
- **Line I provides the Net Book Value for Other Major Assets.**
- **Documentation such as contracts, purchase orders, receiving reports, transfer documents, and records of property in possession of contractors must be available to support the dollar amount on the balance sheet and the associated notes.**

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General PP&E also includes land and facilities such as buildings and structures. They are considered tangible assets used by an entity and have a useful life of at least two years. If their acquisition cost equals or exceeds the DoD capitalization threshold (\$100,000.00), they are capitalized and depreciated.

When computing depreciation, buildings, facilities, and structures do not have a salvage value. The recovery period for buildings, hangars, warehouses, fuel storage buildings, air traffic control towers, and other real property buildings is 40 years.

General PP&E includes buildings, other structures, and facilities included on Note 10, General PP&E, Net. Line B provides a Net Book Value of Buildings, Structures, and Facilities. Line I provides the Net Book Value for Other Major Assets.

These assets are recorded in property accountability and/or accounting systems, assigned a dollar value, and supported by documentation such as contracts, receiving reports, work orders, or construction contractors. This documentation (original documents and/or hard and electronic copies of original documentation) should be maintained in a readily available location during the applicable retention period, to permit the validation of information pertaining to the asset, such as the acquisition cost, the acquisition date, and the cost of any improvements.

The Other Structures and Facilities Account is used to account for DoD-controlled utilities and improvements to land, and facilities not classified as buildings. Property records provide an audit trail of the transactions suitable for audit.

We discussed buildings, other structures, and facilities. Let's now discuss leasehold improvements.





## General PP&E (cont.)



Leased property is:

- capital leases, operating leases, and leasehold improvements
- capitalized if it meets or exceeds the DoD threshold of \$100,000.00
- depreciated for the remainder of the lease period or 20 years
- reported on the Department's financial statements.

### Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in millions)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	\$ 574.6	\$ 574.6
B. Equipment	11.3	2.6
C. Accumulated Amortization	(379.2)	(343.6)
D. Total Capital Leases	\$ 206.7	\$ 233.6

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

### Fluctuations

Assets Under Capital Lease decreased \$26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

### Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

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General PP&E include capital leases, operating leases, and leasehold improvements.

On the Balance Sheet, Note 10, there are major asset categories. One of the categories is Assets Under Capital Lease. The example on the slide shows the detail information on Assets Under Capital Lease including land and buildings, equipment, accumulated amortization, and the total amount. The total on Note 10 must agree with the detail on Assets Under Capital Lease.

The value of the improvements to leased property, as well as easements and rights of way, are capitalized if they meet or exceed the DoD capitalization threshold of \$100,000.00.

The recovery period is the remainder of the lease period or 20 years, whichever is less.

It is important to recognize the leasehold improvements, record them correctly, and depreciate them correctly, or it could adversely affect the accuracy of financial statements.

We discussed leasehold improvements, capitalization, and the recovery period. Now we can discuss the three categories of internal use software.





## General PP&E (cont.)



**Internal use software consists of:**

- **Commercial of-the-shelf (COTS)**
- **Software developed internally by the DoD**
- **Software developed by a paid DoD contractor**
- **Software embedded in military equipment (not capitalized).**

**Criteria for capitalization of internal use software:**

- **Software meets or exceeds threshold of \$100,000.00.**
- **For COTS threshold, includes actual cost plus any internal cost.**
- **For internally developed software, includes any direct or indirect cost incurred during developmental stage.**
- **For contractor-developed software, includes amount paid to contractor to develop software.**

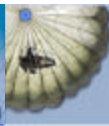
Here are the three categories of software. This software is owned and used for operational or other internal use. Some exceptions are software integrated in General PP&E and Special Test Equipment.

COTS is software purchased from a vendor that is ready for use with little or no change. Software developed internally is software that employees of the Department actively develop, including new software and existing or purchased software that is modified with or without contractor's assistance. Software developed by a contractor is software that the Department pays a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

The software is capitalized if it meets or exceeds the DoD threshold for capitalization of \$100,000.00. For COTS, the threshold is the actual cost, plus any internal costs. For internally developed software, it includes any direct or indirect costs incurred during the developmental stage. For contractor-developed software, it includes the amount paid to the contractor to develop the software.

Now that we have discussed the different categories of software, we can discuss the categories of equipment.





## General PP&E (cont.)



### General Equipment Categories

- Technology
- Communication
- Automation Equipment
- Transportation
- Information Technology
- ADP Equipment



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Examples of non-specific systems used for accounting and financial statement reporting purposes consist of dedicated equipment or components linked together and used in the performance of a service or function in support of a mission of a Department component, command, or installation.

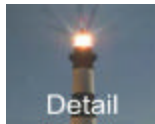
This system would be capitalized and depreciated when the total cost of the system equals or exceeds the DoD capitalization threshold and has an expected useful life of two or more years.

Examples of ADP systems are the Standard Finance System (STANFINS), Standard Accounting and Reporting Systems - Field Level (STARS-FL), and Standard Operation and Maintenance Army Research and Development System (SOMARDS).

Maintenance or repair costs to general equipment, even if they may exceed the DoD capitalization threshold, are expensed.

We discussed the general types of equipment. Now we discuss the different types of military equipment.





## General PP&E (cont.)



**Military equipment includes items such as aircraft, ships, satellites, and tanks, and the Department is required to:**

- **treat military equipment as General PP&E in accordance with SFFAS No. 23, dated May 8, 2003**
- **capitalize and depreciate the military equipment if it meet or exceeds the capitalization threshold of \$100,000.00**
- **report the military equipment on the DoD's financial statements.**

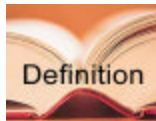
The FASAB adopted SFFAS No. 23 on May 8, 2003, requires the Department to treat military equipment as General PP&E.

The military equipment had to be valued, and if it was above the DoD capitalization threshold, it would have to be capitalized and depreciated. It would then have to be reported on the DoD's financial statements.

The Property and Equipment Policy (P&EP) Office, under the Director, Acquisition Resources and Analysis, Office of the Under Secretary of Defense (OUSD) Acquisition, Technology, and Logistics (AT&L), was established to coordinate and oversee Department efforts to resolve existing PP&E accountability, accounting, and reporting problems.

We have discussed military equipment and its reclassification to General PP&E. Now we can discuss the guidance for assets acquired under capital lease.





## General PP&E (cont.)



**Capital leases are leased General PP&E acquired by the DoD that are considered either personal or real property. The Department is required to:**

- **comply with guidance in the DoDFMR**
- **maintain documentation to identify and account for General PP&E acquired by capital lease**
- **record cost for capital leases including the cost at inception, plus any other consideration**
- **depreciate the General PP&E if it meets or exceeds the DoD threshold of \$100,000.00.**

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General PP&E includes assets acquired through capital leases, including leasehold improvements. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee such as capitalization, clean-up costs, condition assessment surveys, cost objective, and deferred maintenance.

The criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB provides for additional criteria which relates to the level of private sector risk involved in a lease-purchase agreement.

Following are the four criteria.

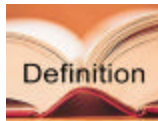
- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life.
- The present value of rental and other minimum lease payments, excluding that portion of the payment representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels. The asset is depreciated if it meets or exceeds the DoD capitalization threshold, and the accumulated depreciation is accounted for in the Accumulated Depreciation on Assets Under Capital Lease Account.

An example of a capital lease is the acquisition of a fire truck that has a recovery period of five years. The fire truck would be depreciated over a period of five years. An account called Assets Under Capital Lease is used to record the present value of the asset and payments during the term of the lease.

We discussed capital leases. Now let's discuss construction in progress.





## General PP&E (cont.)



**Construction-in-Progress (CIP) account is used to accumulate costs of real property construction projects. DoD components are required to:**

- **accumulate costs regardless of the type of funds used**
- **account for balances provided by the USACE and NAFAC and report the amounts on the financial statements**
- **capitalize the accumulated costs if they meet or exceed the DoD capitalization threshold of \$100,000.00**
- **expense the amount if it does not meet the capitalization threshold**
- **capture all appropriate costs while the asset is under construction.**

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Documentation for Audits of PP&E

L2-25

The account Construction-in-Progress (CIP) is used to accumulate costs of real property construction projects. These costs are accounted for regardless of the type of funds used such as Military Construction, Minor Construction, and Operations and Maintenance.

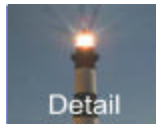
The DoD component that receives the CIP shall report the CIP amounts on its financial statements regardless of the type of funds used for the project. These balances are provided annually by the U.S. Army Corps of Engineers (USACE) and Navy Facilities Engineering Command (NAFAC) to the appropriate reporting component along with supporting documentation in sufficient detail to reconcile the CIP balances by project and funding source.

When the project is completed, the accumulated costs, if they equal or exceed the DoD capitalization threshold, are transferred to the proper General PP&E account. If the accumulated costs do not meet the DoD capitalization threshold, they are expensed in the year management determines that the capitalization threshold was not met.

Equipment such as heating or air conditioning systems that is installed and cannot be removed without dismantling the property is included in the CIP account. If the accumulated cost at completion equals or exceeds the DoD capitalization threshold, the cost is transferred to the appropriate PP&E account. All appropriate costs associated with the CIP are captured.

We discussed CIP. Now let's discuss Other General PP&E.





## General PP&E (cont.)



**The Other General PP&E Account is used to account for:**

- **property removed because of BRAC**
- **assets removed from the General PP&E account and recorded at their NRV**
- **assets removed from service and sent to depots for future use.**

An account called Other General PP&E is used to account for property removed because of BRAC.

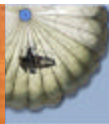
The asset is removed from the PP&E account and recorded in the Other General PP&E account at its net realizable value (NRV).

If there is a difference between book value of the asset and the NRV, the value is recognized as a gain or loss in the period of adjustment.

This account is used if an asset has been removed from service and sent to a depot for future use. The asset remains on the appropriate general ledger account and continues to be depreciated.

That concludes the presentation on General PP&E. We now discuss documentation and why it is important in the audit process and to auditors.





## Documentation



**Consistent and complete accounting records must be maintained to support financial transactions and financial control of asset transactions within the DoD.**

**DD Form 250**

**DD Form 1662**

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Documentation for Audits of PP&E

L2-27

Supporting documentation shall be available when recording General PP&E in a property accountability and/or accounting system. If no documentation is available, estimates of the cost of the PP&E shall be made, as well as estimates for the accumulated depreciation that has taken place up to the time the asset was received.

Department components should retain any historical documentation supporting a capital asset's acquisition date or cost, or both, and make it available to auditors on request. This source documentation should be kept for the life of the asset.

To achieve an unqualified audit opinion, it is necessary to work diligently during the year to ensure that all transactions are supported by the appropriate documentation. For your agency to achieve this, documentation is important because it provides the principal support for the auditor's report. The auditor is asking you to provide this documentation.

The documentation prepared by the Department to support their transactions is the basis used by the auditors to determine if the DoD's financial information is sufficient, competent, and relevant for the financial transactions.

Examples of documentation include contracts; DD Form 250, Material Inspection and Receiving Report; DD Form 1354, Transfer and Acceptance of Military Real Property; and DD Form 1662, DoD Property in the Custody of Contractors.

Let's talk about the important of supporting documentation and how we establish an audit trail for these assets.





## Documentation (cont.)



**Consistent and appropriate records furnish a clear audit trail to protect the financial rights of the government and the entity involved in the financial transactions.**

TRANSFER AND ACCEPTANCE OF MILITARY REAL PROPERTY												Form Approved OMB No. 0704-0188																																																																													
1. PREPARED BY (Name, Title, and Organization)												2. DATE PREPARED																																																																													
3. PROJECT OR CONTRACT NUMBER												4. SERIAL NUMBER																																																																													
5. TRANSFER DETAILS												6. DATE TRANSFERRED																																																																													
7. CONTRACT NUMBER												8. DOWNGRADING NUMBER																																																																													
9. TRANSFER TYPE												10. EFFECTIVE DATE																																																																													
11. FROM (Donor/Transferor)	12. TO (Recipient/Transferee)	13. OFFICE OF USE	14. OFFICE OF USE	15. OFFICE OF USE	16. OFFICE OF USE	17. OFFICE OF USE	18. OFFICE OF USE	19. OFFICE OF USE	20. OFFICE OF USE	21. OFFICE OF USE	22. OFFICE OF USE	23. OFFICE OF USE	24. OFFICE OF USE	25. OFFICE OF USE	26. OFFICE OF USE	27. OFFICE OF USE	28. OFFICE OF USE	29. OFFICE OF USE	30. OFFICE OF USE	31. OFFICE OF USE	32. OFFICE OF USE	33. OFFICE OF USE	34. OFFICE OF USE	35. OFFICE OF USE	36. OFFICE OF USE	37. OFFICE OF USE	38. OFFICE OF USE	39. OFFICE OF USE	40. OFFICE OF USE	41. OFFICE OF USE	42. OFFICE OF USE	43. OFFICE OF USE	44. OFFICE OF USE	45. OFFICE OF USE	46. OFFICE OF USE	47. OFFICE OF USE	48. OFFICE OF USE	49. OFFICE OF USE	50. OFFICE OF USE	51. OFFICE OF USE	52. OFFICE OF USE	53. OFFICE OF USE	54. OFFICE OF USE	55. OFFICE OF USE	56. OFFICE OF USE	57. OFFICE OF USE	58. OFFICE OF USE	59. OFFICE OF USE	60. OFFICE OF USE	61. OFFICE OF USE	62. OFFICE OF USE	63. OFFICE OF USE	64. OFFICE OF USE	65. OFFICE OF USE	66. OFFICE OF USE	67. OFFICE OF USE	68. OFFICE OF USE	69. OFFICE OF USE	70. OFFICE OF USE	71. OFFICE OF USE	72. OFFICE OF USE	73. OFFICE OF USE	74. OFFICE OF USE	75. OFFICE OF USE	76. OFFICE OF USE	77. OFFICE OF USE	78. OFFICE OF USE	79. OFFICE OF USE	80. OFFICE OF USE	81. OFFICE OF USE	82. OFFICE OF USE	83. OFFICE OF USE	84. OFFICE OF USE	85. OFFICE OF USE	86. OFFICE OF USE	87. OFFICE OF USE	88. OFFICE OF USE	89. OFFICE OF USE	90. OFFICE OF USE	91. OFFICE OF USE	92. OFFICE OF USE	93. OFFICE OF USE	94. OFFICE OF USE	95. OFFICE OF USE	96. OFFICE OF USE	97. OFFICE OF USE	98. OFFICE OF USE	99. OFFICE OF USE	100. OFFICE OF USE

**DD Form 1354**

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Documentation for Audits of PP&E

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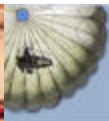
Audit trails are documentation of transactions from their inception to the final disposition and reporting in financial or property systems. These audit trails are essential to auditors and to the day-to-day operations of an entity. All transactions must be traceable to the original source records.

The DoDFMR provides information on supporting documentation when General PP&E is acquired. The documentation, either the original documents and/or hard or electronic copies of the original documentation, shall be retained. This documentation shall be readily available to support the acquisition cost, acquisition date, and any cost of improvements to the asset. Supporting documentation may include, but is not limited to, purchase invoices, sales and procurement contracts, DD Forms 1354, construction contracts, work orders, and other types of documentation generated by the department in possession of the asset.

This guidance pertains to all Department personnel and is provided to establish consistent and proper documentation and records management. These records should be properly maintained for financial transactions as well as those transactions to support the proper value of all capital assets. The lack of this source documentation leads to audit deficiencies.

Now that we have this source documentation, what do we do with it and how long do we have to maintain it?





## Documentation (cont.)



### Document Retention

- **Varies depending upon type**
- **Includes:**
  - acquisition/purchase vouchers
  - contract, as appropriate
  - valuation report
  - DD Form 250
  - DD Form 1354
  - DD Form 1662
  - inventory records
  - MOU on use, as appropriate.



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Documentation for Audits of PP&E

L2-29

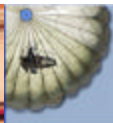
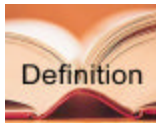
The DoDFMR provides guidance on the retention for financial records of the Department. The financial records, both paper and electronic documenting the acquisition of PP&E and other financial transactions, shall be maintained. The retention period (at least 6 years and 3 months) varies depending on the type of document and asset.

These records include supporting documentation for the acquisition of property, PP&E, materials and supplies, cash, fixed and other assets, real and personal property, operating materials and supplies, stockpile materials, services, military and civilian pay, and any other financial transactions.

In some instances, there may be supplemental guidance requiring activities to maintain records for a longer period. For example, the DoDFMR, Chapter 6, Volume 15, requires that Foreign Military Sales (FMS) records shall be maintained for 10 years from the date of closure.

We have talked about document retention. Now let's look at a summary of supporting documents by category.





## Documentation (cont.)



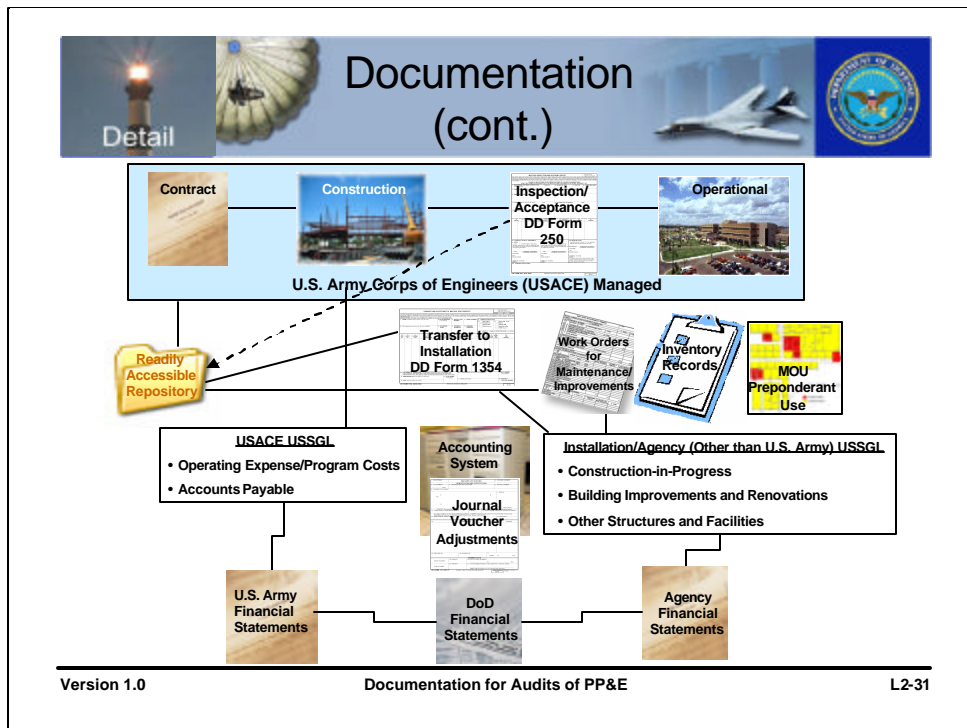
### Summary of documents by category:

- **When General PP&E is purchased:**
  - Contracts, acquisition/purchase vouchers, or valuation reports
- **When General PP&E is received:**
  - DD Form 250, Material Inspection and Receiving Report
  - ENG Form 3013, Work Order/Completion Report
  - DD Form 1354, Transfer and Acceptance of Military Real Property
- **When property is in the custody of contractors:**
  - DD Form 1662, DoD Property in the Custody of Contractors
- **When property is on DoD Property Records:**
  - DD Form 1342, DoD Property Record

These are some examples of supporting documents when General PP&E is purchased, received, in custody of contractors, and when property is on DoD property records.

Let's review what we discussed regarding General PP&E and source documentation.





In examining the effect of a transaction and its related documentation and general ledger entries on the agency's financial statements, let's use the example of a construction project initially managed by the U.S. Army Corps of Engineers at a military installation other than Army.

This diagram depicts various interrelationships involved in developing and subsequent placing in operations of the building. Each of these events require appropriate documentation to support the resulting accounting transactions to be recorded in the general ledgers of the appropriate entity. It shows the capturing of the data at various levels, until the information is summarized in the department's financial statements.

Let's summarize the lesson.





## Lesson Summary



- **General PP&E, acquisition, capitalization, applicable guidance, and how we account for these assets.**
- **Different types of source documentation, guidance, importance, and retention of documentation.**

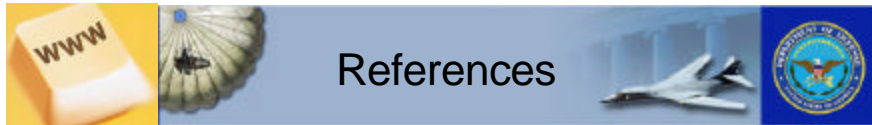
In this lesson, we discussed key information that will assist you in obtaining a clean audit.

In this lesson, we discussed the three categories of PP&E: General PP&E, Stewardship Land, and Heritage Assets. We discussed the procedures for capitalization and depreciation. We provided examples of preponderant use and explained which Department component should recognize the asset on its financial statements. You were introduced to capital improvements and the procedures for capitalization and depreciation. We mentioned the different types of land and land rights such as easements.

We discussed the three categories of internal use software: COTS, software developed internally by the DoD, and software developed by a paid DoD contractor. Information was provided on assets under capital lease such as the example of leasing a fire truck. We discussed CIP and the requirements for capitalization and depreciation. Most importantly, we discussed different types of supporting documentation, the importance of this documentation in audits, and that there are requirements for how long the documentation must be maintained.

Let's look at some references.





**DoDFMR, Volume 1, Chapter 9; Volume 4, Chapter 6; and  
Volume 6B, Chapter 11:**

**<http://www.dod.mil/comptroller/fmr/>**

**DoD Directive 5015.2-R:**

**<https://dfas4dod.dfas.mil/library/corp>**

**DFAS 5012.2-M: <https://dfas4dod.dfas.mil/library/corp>**

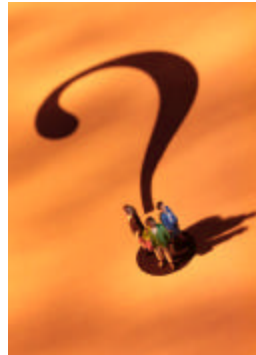
**DFAS 5015.2-I: <https://dfas4dod.dfas.mil/library/corp>**

**NARA: <http://www.archives.gov>**

**SFFAS Nos. 6, 8, 10, and 11: <http://fasab.gov>**

This slide lists references available for additional information.



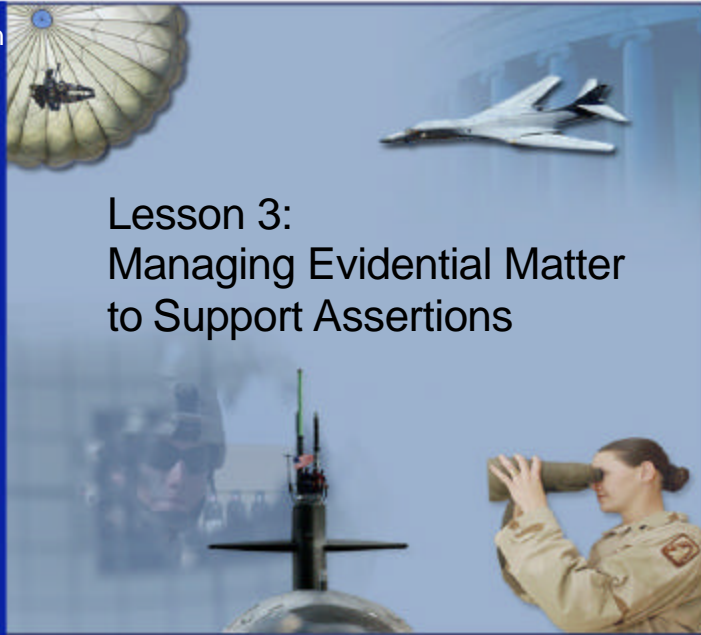




Documentation  
for Audits of  
Property,  
Plant, and  
Equipment



## Lesson 3: Managing Evidential Matter to Support Assertions



In this lesson, we are going to learn about how to manage evidential matter to support assertions.

You are here to understand the importance of managing evidential matter as it relates to assertions. Assertions are representations made by management that are embodied in financial statements components. In this lesson, we will discuss the five categories of assertions. Most of the auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements.

Let's discuss the lesson objectives.





**Upon successful completion of this lesson, you will be able to:**

- **explain reporting requirements**
- **demonstrate reconciliation tools and their usage.**

Upon successful completion of this lesson, you will understand the reporting requirements of contractors when they receive or acquire government material. In addition, you will learn about reconciliation tools and how they are used by the Department to obtain an unqualified audit opinion.

Let's discuss the lesson topics.





**This lesson contains the following topics:**

- **evidential matter**
- **assertions**
- **how to report government property in the possession of contractors**
- **how to use reconciliation tools for validation.**

These are the topics in this lesson. We will discuss evidential matter; assertions; reporting requirements for government property in the possession of contractors which includes regulatory guidance, internal controls, and source documentation; and the last topic is how to use reconciliation tools for validation.

Let's discuss evidential matter and assertions, and their importance when audits are conducted.





## Evidential Matter



**Evidential matter consists of accounting data and all corroborating information made available to auditors.**

The GAO Yellow Book requires that relevant, sufficient, and competent evidence be obtained through inspection, observation, inquiries, and confirmation to afford a reasonable basis for an opinion regarding the financial statements being audited.

**Real property audit example:**

- **DD Form 1354 review for relevant, sufficient, reliable information**
  - receiving and transferring agency
  - correct quantity, cost, any construction deficiencies, signatures
- **Invoices, receiving reports, contracts, other documents**
- **Obtaining and evaluating evidence to support a fair presentation of the financial statements.**

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Documentation for Audits of PP&E

L3-4

When we talk about evidential matter, it consists of hard or electronic copies of original source documentation. It is considered competent when it is relevant, sufficient, and reliable. These are some terms that auditors may use when conducting an audit.

Relevant means that the evidential matter relates to the specific audit objective being tested. Reliable refers to whether the evidence signals the true state of the assertion or audit objective. There are some specific requirements in the GAO Yellow Book regarding evidential matter (we will discuss the Yellow Book in more detail later in the lesson).

For example, an audit is conducted of real property, and the auditor is reviewing a DD Form 1354 (Transfer and Acceptance of Military Real Property). When examining this form, the auditor examines it for relevant, sufficient, and reliable information to form an opinion. The form should contain the receiving and transferring agency, correct quantity, cost, any construction deficiencies, and appropriate signatures.

During an audit, the auditors examine the DD Form 1354, invoices, receiving reports, contracts, and other types of relevant and reliable evidential matter to form an opinion. According to the GAO Yellow Book, evidence from independent sources provides more assurance than evidence provided from within the entity. Effective internal controls provide more assurance about the reliability of the accounting and financial data. The auditors rely on this information to form an opinion during their audits. During a typical audit engagement, auditors' work involves obtaining and evaluating evidence to test the fair presentation of the financial statements.

Let's look at some examples of evidential matter.





## Evidential Matter (cont.)



**Types of evidential matter obtained during an audit of financial statements:**

- **Physical**
- **Documentary**
- **Testimonial**
- **Analytical**

**Example – management makes an assertion that PP&E is recorded correctly on the financial statements. To verify the PP&E was recorded in the property accountability system at the right quantity and cost they should verify:**

- **DD Form 250 (Material Receipt and Inspection Report)**
- **DD Form 1342 (DoD Property Record).**

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Documentation for Audits of PP&E

L3-5

During an audit, auditors use evidential matter to form an opinion regarding the agency's financial statements. The auditors develop audit objectives based on the assertions made by management and review the evidential matter. Types of evidential matter include:

- physical, which is obtained through direct inspection or observation
- documentary, which includes laws, regulations, contracts, inventory reports, and purchase orders
- testimonial, which includes inquiries, interviews, and questionnaires
- analytical, which includes statistical sampling, comparisons, and ratios.

The auditors form their opinion on financial statements by obtaining and evaluating evidential matter concerning the assertions in such financial statements. For example, management makes an assertion that the PP&E is recorded correctly in the financial statements. The auditors would look at supporting documentation such as DD Form 250 (Material Receipt and Inspection Report) or DD Form 1342 (DoD Property Record) to verify that the PP&E was recorded in the appropriate property accountability system and for the right quantity and cost.

Let's examine the guidance that dictates how to maintain all of these different types of evidential matter.





## Evidential Matter (cont.)



### **Requirements for maintaining the availability of evidential matter:**

- **DoDFMR, Volume 1, Chapter 9**
- **DoDFMR, Volume 4, Chapter 6**
- **U.S. National Archives and Records Administration**
- **Defense Finance and Accounting Service**
- **Agency Policies**

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Documentation for Audits of PP&E

L3-6

Specific guidance for maintaining records is contained in the DoDFMR, NARA regulations, and DFAS records management procedures. Source documents must contain sufficient information to track a single transaction from its inception to the financial statements and from the financial statements back to the source documents. When we properly maintain this documentation, it establishes an audit trail that is important during the audit of our financial statements.

DoDFMR Volume 1, Chapter 9, Financial Records Retention, provides guidance for financial records created or received and maintained by all elements of the DoD. This DoDFMR makes reference to the NARA and their responsibility for providing guidance and assistance for the management and disposition of records.

DoDFMR Volume 4, Chapter 6, Property, Plant, and Equipment, states that the dollar value of an asset shall be supported by appropriate documentation. This documentation should be maintained in a readily available location, during the applicable retention period, to permit the validation of information pertaining to the asset, such as the acquisition cost, the acquisition date, and any cost improvements. For example, contractors are required to report all Department property in their custody on a DD Form 1662. The Department would report this property on its balance sheet.

The NARA sets policy and establishes standards, procedures, and techniques for the disposition of all federal records in accordance with 44 U.S.C., Chapters 21, 29, 31, and 33. The head of each agency is required to establish and maintain a records disposition program. Each agency established policies to meet the requirements of the FMR and NARA. For example, DFAS 5015.2-R, Records Management Program, applies to all DFAS business lines, corporate elements, and records maintained by contractor personnel who have engaged in formal agreements with DFAS.

Now let's look at what the FMR says about internal controls within accounting systems.





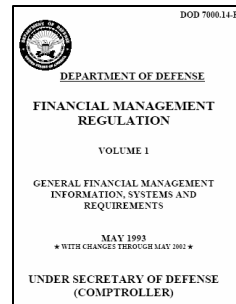
## Evidential Matter (cont.)



**DoDFMR, Volume 1, Chapter 3, Accounting Systems Conformation, Evaluation, and Reporting, provides information on:**

- **accounting systems**
- **key accounting requirements**
- **material deficiencies.**

**A key aspect of internal control is to maintain adequate documentation to allow tracing any transaction from the financial statements to the originating source document and vice-versa.**



**Audit trails allow for detection and tracing of suspended or rejected transactions, such as unmatched disbursements (UMDs).**

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Documentation for Audits of PP&E

L3-7

The DoDFMR provides information on the structure of the accounting system. There are thirteen key accounting requirements listed in the DoDFMR. A departure from a key accounting requirement could lead to a material deficiency such as loss of control of resources, impair the DoD mission, allow fraud or other criminal activities to go undetected, create adverse publicity for the Department, or cause violations of statutory requirements (obligations or expenditures in excess of funds).

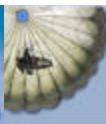
A key aspect of internal controls is maintaining adequate supporting documentation to support transactions on your financial statements. There must be documentation that can be traced from the line items on your financial statements to the source documents. This is called an audit trail.

Key accounting requirement number 8 describes a proper audit trail. An audit trail should allow a transaction to be traced from initiation through processing to final reports. Source records for an audit trail include transaction type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction.

These audit trails allow for the detection and tracing of suspended or rejected transactions, such as unmatched disbursements, for correction in a reasonable timeframe.

Let's discuss some key reasons for maintaining evidential matter.





## Evidential Matter (cont.)



### **Key reasons for maintaining evidential matter:**

- **Required by regulations and law**
- **Establishes audit trails**
- **Increases accountability**
- **Assists in obtaining an unqualified audit opinion**

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Documentation for Audits of PP&E

L3-8

The FMFIA established compliance and requirements for federal agencies for obligations, safeguarding of assets, and properly recording of revenues and expenditures. When audit trails are established, accountability in these areas is established.

You learned that the GPRA was enacted to hold agencies accountable for their program's results. Fiscal accountability is increase when there is evidential matter available to support areas such as establishing standards, defining missions, preparing plans, measuring performance, and identifying performance gaps and performance goals.

OMB Circular A-123 strengthened the requirement for conducting management's assessment of internal controls. When audit trails for financial transactions are established as mentioned in the DoDFMR, accountability and effectiveness of operations are increased. You can understand that relevant, sufficient, and competent evidential matter is necessary to afford a reasonable basis for an unqualified audit opinion. Most of the auditor's work involves obtaining and evaluating evidential matter to test the fair presentation of your financial statements.

Audit trails are not just for auditors. They are used by DoD personnel to monitor the quarterly un-audited financial statements.

Let's examine what is meant by the term assertions.





## Assertions



**Assertions are representations by management that are embodied in financial statements components. They can be either explicit or implicit and can be classified in five broad categories.**

**Example assertion statement: “This memorandum is to inform the Inspector General of the Department of Defense that the (ie: Army General Fund) has completed corrective actions of the material deficiencies on the (ie: Accounts Receivable) line item on the (ie: balance sheet). (ie: Accounts Receivable) is fairly presented in accordance with generally accepted accounting principles and is ready for audit. We have also completed the attached checklist indicating our preparedness.”**

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Documentation for Audits of PP&E

L3-9

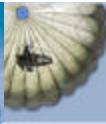
Assertions are representations by management that are embodied in financial statements components. They can be either explicit or implicit and can be classified in five broad categories (these will be explained in some detail in a moment).

This management assertion letter taken from the USD(C) Memorandum dated June 23, 2004, on Financial Improvement Initiative Business Rules, details the management assertions for the DoDIG that reads: “This memorandum is to inform the Inspector General of the Department of Defense that the (ie: Army General Fund) has completed corrective actions of the material deficiencies on the (ie: Accounts Receivable) line item on the (ie: balance sheet). (ie: Accounts Receivable) is fairly presented in accordance with generally accepted accounting principles and is ready for audit. We have also completed the attached checklist indicating our preparedness.”

An auditor’s work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in your financial statements. After obtaining evidential matter in support of financial statements assertions, the auditors develop audit objectives and design substantive tests for those assertions. These substantive tests are methods used to verify and validate information.

Now let’s look at the five broad categories of assertions.





## Assertions (cont.)



### The Five Categories of Assertions

- **Existence or occurrence (example follows)**
  - Management asserts PP&E on balance sheet physically exists.
  - Auditors develop tests to verify the assertion.
    - Observe property counts.
    - Obtain confirmation of PP&E at locations outside the entity.
    - Test PP&E transactions between a preliminary physical inventory date and the balance sheet date.
- **Completeness**
  - Management asserts all purchases of PP&E are on balance sheet.
  - Auditors conduct tests to verify the assertion.
- **Rights and obligations**
  - Management asserts that all PP&E assets and liabilities stated on balance sheet belong only to that entity.
  - Auditor conduct tests to verify the assertion.
- **Valuation and allocation**
  - Management asserts that the PP&E is recorded at historical cost and allocated to the appropriate accounting period.
  - Auditor conduct test to verify the assertion.
- **Presentation and disclosure**
  - Management asserts that amounts presented as extraordinary items in the income statement are properly classified.
  - Auditor conduct tests to verify the assertion.

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Documentation for Audits of PP&E

L3-10

An assertion made by management about the existence or occurrence addresses whether PP&E assets or liabilities exist at a given date and whether recorded transactions have occurred during a given period. For example, in the existence or occurrence category, management asserts that all of the PP&E included in the balance sheet physically exists. The auditors develop substantive tests to verify the assertion made by management. The auditors could observe property counts, obtain confirmation of PP&E at locations outside the entity, or test PP&E transactions between a preliminary physical inventory date and the balance sheet date.

An assertion made by management about completeness addresses whether all PP&E transactions and accounts that should be presented in the financial statement are included. For example, the department asserts that all purchases of PP&E are included in their financial statements. Based on this assertion by the department, the auditors would conduct substantive tests to determine if all of the PP&E are included in the financial statements.

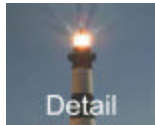
An assertion made by management about rights and obligations addresses whether PP&E assets are the rights of the department and the liabilities are the obligations of the department at a given date.

An assertion made by management about valuation and allocation addresses whether the assets, liabilities, equity, revenues, and expenses have all been included in the financial statements at the appropriate amounts. For example, the department asserts that the PP&E is recorded at historical cost and that cost is systematically allocated to the appropriate accounting periods. The auditor would ensure that the property was valued correctly and the amount was authorized.

An assertion made by management about presentation and disclosure addresses whether particular components of the financial statements are properly classified, described, and disclosed. For example, management asserts that amounts presented as extraordinary items in the income statement are properly classified and described. The auditors analyze the supporting evidential matter for these management assertions.

Let's illustrate how management assertions relate to the requirement for audit evidential matter.





## Assertions (cont.)



### Financial Statement Assertions to Evidential Matter

- The entity prepares the financial statements.
- Management makes assertions.
- The auditors develop audit objectives and specific tests.
- The auditors establish audit procedures on how they will test and sample reliable and relevant source documentation.
- With the support of the entity's staff, the auditors review evidential matter.
- The audit report summarizes the results.
- Management takes corrective action to represent the financial statements fairly.

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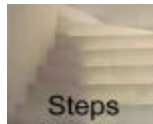
L3-11

Here are the chain of events following management assertions made by the publication of financial statements.

- The entity prepares the financial statements.
- Management makes assertions.
- The auditors develop audit objectives and specific substantive tests.
- The auditors establish audit procedures on how they will test and sample reliable and relevant source documentation.
- With the support of the entity's staff, the auditors review evidential matter.
- The audit report summarizes the results.
- Management takes corrective action to represent the financial statements fairly.

Now let's discuss the applicable guidance the Department and contractors must follow when accounting for property in the possession of contractors (PIPC).





## How to Report Government Property in the Possession of Contractors



### **Regulatory guidance for contractors:**

- **DoDFMR, Volume 4, Chapter 6, Property, Plant, and Equipment**
- **Federal Acquisition Regulation, Part 45, Government Property**

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L3-12

The guidance, policy, and procedures for accountability of PIPC is contained in the DoDFMR and the FAR. These regulations establish guidance for the department to follow regarding financial and property accountability procedures.

When General PP&E is in possession of the contractor, it must be under continuous accounting and property control and only used for proper and authorized purposes, safeguarded from theft, abuse, waste, and unauthorized use.

Let's discuss some supporting documentation for this type of PP&E.





## How to Report Government Property in the Possession of Contractors (cont.)



### **DoDFMR, Volume 4, Chapter, Property, Plant, and Equipment Guidance for Contractors:**

- **Accountability of property**
  - **recognized at delivery**
  - **recognized at constructive delivery**
- **Documentation of property**
  - **reported on DD form 1662**

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L3-13

The DoDFMR establishes procedures for the accountability and documentation of government property in the possession of contractors. When General PP&E is acquired by a contractor on behalf of a DoD component, the DoD component ultimately holds title to the assets. The General PP&E is recognized upon delivery or constructive delivery, whether to the contractor performing the service, or to the DoD component. The term delivery or constructive delivery is based on the requirements of the contract regarding shipping and/or delivery.

Contractors are required to report DoD property in its possession to the property administrator on an annual basis. The property is reported on a DD Form 1662 and includes land, other real property, other plant equipment, industrial plant equipment, special test equipment, special tooling, and military property. Contractor-acquired and government-furnished material are also reported on the DD Form 1662.

When a contractor is in possession of government property, it is exempt from the inventory guidance in the DoDFMR. The contractor is subject to the property accountability requirements in the Federal Acquisition Regulation (FAR).

Let's discuss the contractor's requirements in the FAR.





## How to Report Government Property in the Possession of Contractors (cont.)



### **Federal Acquisition Regulation Requirements for Contractors:**

- **Authorization for purchases**
- **Procedures for recording property**
- **Inventories of property**
- **Transfer to government**
- **Disposal of property**

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L3-14

The FAR establishes procedures for contractors regarding purchases, recording, inventory, transfer, and disposal of property. Contractors are responsible for the control of government property when property is purchased by the contractor and the contract calls for reimbursement by the government. If evidence of receipt is required for contractor-acquired property, the contractor shall provide it before submitting its request for payment for the property.

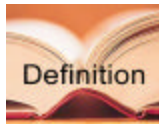
The contractor establishes and maintains adequate property control records of government property including property in the possession of subcontractors. These records should be complete, current, and auditable by the government. This property control system shall contain a system or technique to locate items of government property within a reasonable period of time.

The contractor conducts periodic physical inventories of all government property in its possession and in the possession of the subcontractors. The type, frequency, and procedures are established with the approval of the property administrator. On an annual basis, the contractor's property control system provides the total acquisition cost of government property for which it is accountable. The contractor reports the government property on a DD Form 1662.

Upon termination or completion of a contract, the contractor performs a physical inventory, adequate for disposal purposes, of all government property applicable to the contract, unless the requirement is waived. This property is used in a follow-on contract or transferred back to the government. If government real property is sold, transferred, donated, destroyed by fire or other cause, the financial accounts are reduced by the presently recorded cost and the real property records annotated with a supporting statement, including pertinent facts.

Let's discuss contractor-acquired property.





## How to Report Government Property in the Possession of Contractors (cont.)



**Contractor-acquired property means property acquired or otherwise provided by the contractor for performing a contract and to which the government has title.**

The requirements for contractor-acquired property are detailed in the DoDFMR and the FAR. The contractor is responsible and accountable for all government property in accordance with the requirements of its contract. This includes both government-furnished and contractor-acquired property.

When the contractor purchases property in accordance with the terms of the contract, it is responsible for providing evidence of receipt in order to obtain reimbursement from the government. The contractor establishes property control records to maintain accountability of all government property in its possession and in the possession of subcontractors. These records are safeguarded and accessible to government personnel. On an annual basis, the property is reported to the property administrator.

Costs incurred by the contractor or government for new construction, including erection, installation, or assembly of government real property in possession of the contractor, shall be capitalized in the official government real property records and financial accounts maintained by the contractor for the government.

Let's discuss contractor-acquired material.





## How to Report Government Property in the Possession of Contractors (cont.)



**Government property in the possession of contractors includes PP&E owned by the Department, or other agency, as well as leased PP&E.**

**Material issued for immediate consumption is not entered in inventory records.**

**Government property may only be furnished to contractors under the criteria, restriction, and documentation requirements addressed in FAR 45.3.**

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L3-16

Receipt and issue documents are used to maintain a file of appropriately cross-referenced documents evidencing receipt, issue, and use of material that is issued for immediate consumption and is not entered in the inventory record as a matter of sound business practice.

For cost-reimbursement contracts, government invoices, contractor's purchase documents, or other evidence of acquisition and issue is accepted as adequate property records for material furnished to or acquired by the contractor and issued directly so as to be considered consumed by the contract.

The contractor is required to take physical inventories of material in stores included in the systems (other than work-in-progress) at least annually.

Let's discuss some types of supportive documents for PP&E.





## How to Report Government Property in the Possession of Contractors (cont.)



### DD Form 1638, Report of Disposition of Contractor Inventory

REPORT OF DISPOSITION OF CONTRACTOR INVENTORY		TO: (Include ZIP Code)		FROM: (Include ZIP Code)		REPORT CONTROL SYMBOL: DD-A&E/Q1430	
SECTION I - SUMMARY		INDUSTRIAL PLANT EQUIPMENT		OTHER CONTRACTOR INVENTORY		TOTAL	
REPORT PERIOD		ACQUISITION COST		ACQUISITION COST		ACQUISITION COST	
1. ON HAND - BEGINNING OF REPORT PERIOD							
2. ADJUSTMENTS							
3. RECEIPTS							
4. AVAILABLE FOR DISPOSITION (Year class 1 - 3)							
5. COMPLETION (See 4b, Remarks)							
6. ON HAND - END OF REPORT PERIOD							
SECTION II - DETAILS OF DISPOSITION ACTIONS		INDUSTRIAL PLANT EQUIPMENT		OTHER CONTRACTOR INVENTORY		TOTAL	
ACQUISITION COST		ACQUISITION COST		ACQUISITION COST		ACQUISITION COST	
PROCEEDS		PROCEEDS		PROCEEDS		PROCEEDS	
8. PURCHASED OR RETAINED AT COST							
9. RETURN TO SUPPLIER							
10. TOTAL REDEPOSITIONS							
a. Other Agency							
b. Other Agency							
c. Other Agency							
11. DONATIONS							
12. SALES							
13. SALES - PROCEEDS TO OVERHEAD							
14. OTHER							
15. DESTROYED OR ABANDONED							
16. TOTAL DISPOSITIONS							
17. TOTAL DISPOSITIONS							
18. TOTAL DISPOSITIONS							
19. APPROVING OFFICIAL							
a. NAME (Last, First, Middle Initial)		b. TITLE		c. SIGNATURE			
DD Form 1638, OCT 96 (EG)		Previous editions are obsolete.		Reset		Designed using Helvetica Pro, 9/10/2008, 1/4/09	

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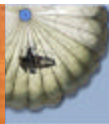
L3-17

When recording a financial transaction for General PP&E, it must have supporting documentation. This is true even for government PIPC that you may no longer have physical custody over. One document that supports the PIPC is the DD Form 1638. This form provides information on industrial plant equipment and other contractor inventory. There are two sections on this form that provide information. Section I provides a summary of items on hand at the beginning of the period and the on balance at the end of the reporting period. Section II provides information on the details of disposition actions.

When completing this form, it is important to record all lines correctly. For example, when Section I – Summary is completed, you should ensure that the beginning balance is correct and any adjustments/receipts during the reporting period are properly recorded. This identifies the on-hand balance for the end of report period.

The acquisition costs and proceeds should be identified in Section II – Details of Disposition Actions. This identifies the total dispositions made by the contractor. This correct dollar amount is important so the entity's property records are properly updated.





## How to Use Reconciliation Tools for Validation



### **Overview of reconciliation tools for validation:**

- **Tools**
- **Business rules**
- **Validation process**
- **Audited financial statements**

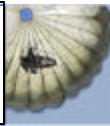
Reconciliation tools are laws and regulations, matrices, questionnaires, internal controls, checklists, and audit committees. These tools are used to improve the operations of an entity and assist in obtaining an unqualified audit opinion on your financial statements.

There are specific laws and regulatory guidance for the preparation of annual financial statements. Some of the guidance includes the Government Management Reform Act, which amended the Chief Financial Officers Act, and OMB Bulletin 01-02, which establishes minimum requirements for audits of financial statements.

OMB Bulletin 01-09 provides the guidance for the form and content of agency financial statements.

Let's discuss some key reconciliation tools used for validation.





## How to Use Reconciliation Tools for Validation (cont.)



### **Key reconciliation tools for validation:**

- **GAO/PCIE Financial Audit Manual**
- **DoDFMR**
- **OUSD(C) Business Rules**
- **GAO Government Auditing Standards**
- **GAO Federal Information System Controls Audit Manual (FISCAM)**
- **Statement on Auditing Standards (SAS) 70/88**
- **FASAB Concepts and Standards**

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Documentation for Audits of PP&E

L3-19

GAO/PCIE FAM is used to ensure that financial audits achieve their intended outcome of providing enhanced accountability over public funds. This publication contains checklists for the 10 sections of the financial statements.

The FMFIA builds upon and complements the CFO Act and GMRA.

The DoDFMR provides accounting policy for the Department.

The OUSD(C) Business Rules were prepared to ensure that the Department achieves an unqualified audit opinion on the FY 2007 financial statements.

GAO Government Auditing Standards contain statements of the auditors' responsibilities and provide an overall framework for ensuring that auditors have competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work.

The GAO FISCAM is designed for information systems auditors and financial auditors who conduct audits of computer-based systems.

SAS 70/88 provides information on standards for service organizations and the consistency of GAAP.

The FASAB mission is to promulgate federal accounting standards.

We are going to concentrate on the OUSD(C) Business Rules for validation.





## How to Use Reconciliation Tools for Validation (cont.)



**Financial Improvement Initiative Business Rules provide information on:**

- **how to get an unqualified opinion on the FY 2007 DoD-wide financial statements**
- **complying with the five phases of the business rules**
- **implementing Section 1008 of the National Defense Authorization Act for FY 2002**
- **preparing a management assertion letter**
- **completing a checklist when performing corrective action validation and while preparing the assertion package.**

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L3-20

DoD Memorandum Financial Improvement Initiative Business Rules, dated June 23, 2004, explains the business rules DoD entities need to follow to get an unqualified opinion. This memorandum includes a graphic depicting the path from a disclaimer to a clean audit opinion. The list of business rules is provided to the military departments and Defense agencies to assist in determining when financial statement line items are ready for assertion and in preparing their assertion package.

The five phases in the business rules are Discovery and Correction, Validation, Assertion, Assessment, and Audit (these were introduced in Lesson 1 and will be explained thoroughly here).

Section 1008 of the National Defense Authorization Act for FY 2002 requires the reliability of the DoD financial statements, including the financial statements of each component of the Department.

A sample management assertion letter is provided in this memorandum. It provides guidance for DoD management to follow when preparing the assertion letter to the DoDIG.

The checklist in the memorandum is used by management to help components prepare for audits by providing the information that is typically needed for financial statements audits. The completed checklist is included as an attachment to the management assertion letter.





## How to Use Reconciliation Tools for Validation (cont.)



### **General Accountability Office/President's Council on Integrity (GAO/PCIE) Financial Audit Manual (FAM)**

- **Volume 1 – Methodology**
- **Volume 2 – Tools**
- **GAO-04-1015G – FAM Update by GAO/PCIE**
- **GAO-04-942G – FAM Update, Checklist for Federal Accounting, Reporting, and Disclosure by GAO/PCIE**

**<http://www.gao.gov/special.pubs/gaopcie/>**

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L3-21

The GAO/PCIE FAM provides guidance for performing financial statement audits of federal entities. This is a key tool for enhancing accountability over taxpayer-provided resources. With the passage of the Government Management Reform Act of 1994, executive branch IGs and GAO gained statutory responsibility for auditing agency and government-wide consolidated financial statements, respectively.

The GAO and PCIE have worked together to ensure that these audits are of the highest possible quality, consistency, and cost-effectiveness. The FAM is a result of that cooperation. The GAO/PCIE FAM consists of two volumes including the two July 2004 updates. Volume 1, Methodology, includes four phases: planning, internal control, testing, and reporting. Volume 2, Tools, includes planning and general, internal control, compliance, substantive testing, and reporting.

The July 2004 updates include:

- GAO-04-1015G FAM, which incorporates the provisions of Auditing Standard 99, Consideration of Fraud in a Financial Statement Audit
- GAO-04-942-G FAM, in which the GAO revised the Checklist for Reports Prepared Under the CFO Act (CFO Checklist).

Let's talk about the Financial Improvement Initiative.





## How to Use Reconciliation Tools for Validation (cont.)



### Financial Improvement Initiative Business Rules

Discovery and Correction	Validation	Assertion	Assessment	Audit
<b>WHY</b> <ul style="list-style-type: none"><li>Discover problems</li><li>Evaluate solutions</li><li>Plan solutions</li><li>Correct processes</li><li>Complete policy</li><li>Complement BMMP</li></ul> <b>HOW</b> <ul style="list-style-type: none"><li>Develop improvement plans</li><li>Establish audit committees</li><li>Develop systems strategy</li><li>Prepare business cases for systems changes</li><li>Prepare and review full set of financial statements each quarter</li></ul>	<b>WHY</b> <ul style="list-style-type: none"><li>Enhance credibility of assertions</li></ul> <b>HOW</b> <ul style="list-style-type: none"><li>At beginning, coordinate and obtain comment from DoDIG and notify RPS</li><li>Management documents processes, identifies controls &amp; systems, and ensures auditable universe of transactions &amp; supporting documentation is available</li><li>Management requests validation of financial information</li><li>Performed by internal review, component's audit agencies, or external audit firm</li></ul>	<b>WHY</b> <ul style="list-style-type: none"><li>Communicate to DoDIG and auditors reliability of financial information</li></ul> <b>HOW</b> <ul style="list-style-type: none"><li>Assertion letter to DoDIG that:<ol style="list-style-type: none"><li>Responds to DoDIG's instructions</li><li>Includes checklist</li><li>Includes results of validation and reports</li></ol></li><li>Engagement letter and management representative letter, if used</li><li>Memo to DoDIG, copy to OUSD (C) RPS</li><li>ESC approval for assessment/audit</li></ul>	<b>WHY</b> <ul style="list-style-type: none"><li>Allows remediation</li><li>Attests to management assertion</li><li>Plan audit</li><li>Reduce risk of unknowns (auditor)</li><li>Introduction to organization (auditors)</li></ul> <b>HOW</b> <ul style="list-style-type: none"><li>DoDIG oversight of IPAs</li><li>DoDIG in-house</li></ul>	<b>WHY</b> <ul style="list-style-type: none"><li>Implement CFO Act</li><li>Implement 1008</li><li>Presidents' Management Agenda</li></ul> <b>HOW</b> <ul style="list-style-type: none"><li>Pass assessment</li><li>DoDIG oversight of IPAs</li></ul>

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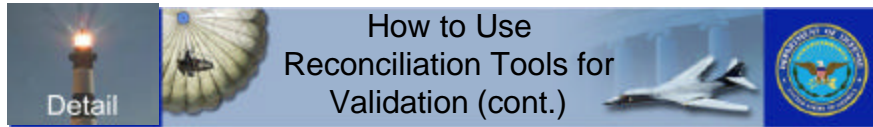
L3-22

DoD is accomplishing the difficult task of improved financial management through several initiatives including the Financial Improvement Initiative. One of the indicators of success is an unqualified audit opinion on the Department's financial statements. The scope of this improvement initiative encompasses policies, processes, controls, defense business systems, personnel, organizations, performance metrics, and auditor assessments and audits that are directly or indirectly related to DoD Financial Management.

The Financial Improvement Initiative is a five-phase process designed to prepare entities to pass a financial audit and to improve their ability to control and report on their financial activities.

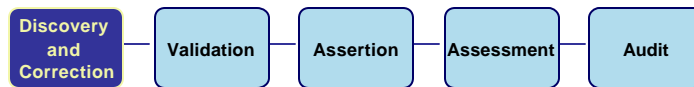
We introduced the five phases of the business rules on Lesson 1. Let's discuss in more detail how we use each of the phases.





### Discovery and Correction Phase

- **Prepare a financial improvement plan.**
- **Establish comprehensive correction plans.**
- **Resolve known deficiencies by designated dates.**
- **Management and audit committees monitor progress.**
- **If new deficiencies are identified, coordinate with OUSD(C) to modify plans to include new additions.**
- **Review financial statements each quarter.**



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L3-23

This phase identifies obstacles that would prevent the entity from obtaining an unqualified audit opinion and to develop improvement plans with solutions for overcoming these obstacles.

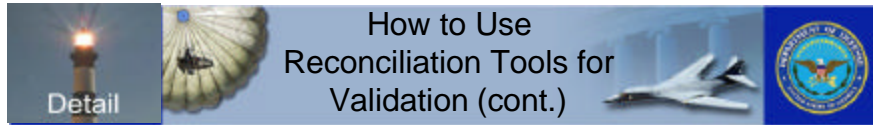
The entity prepares a plan for achieving an unqualified opinion. In its plan, the entity identifies known deficiencies by financial statements line item. The corrective actions are prioritized on those deficiencies that have a material impact on the financial statements.

For example, the Financial Improvement Plan identifies a line item such as the Fund Balance with Treasury with a specific deficiency. The deficiency such as “the reported financial statement balance reconciled with Treasury contains discrepancies that must be resolved.” Management initiates action to resolve the discrepancies and tracks the tasks to be completed by task ID number, responsible office, start date, end date, and status.

Each entity’s management personnel and audit committees should closely monitor the progress when reviewing financial statements on a quarterly basis to ensure that actions taken to resolve these discrepancies are done in the allotted time.

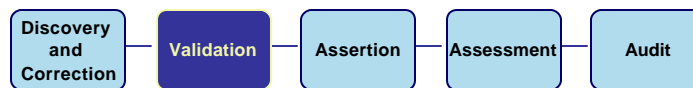
Let’s look at the Validation Phase and how it’s used.





### Validation Phase

- **Implement Section 1008 and enhance the credibility of assertions.**
- **Validate corrective actions identified in the discovery and correction phase.**
- **Provide a limited scope evaluation or review to determine if previous deficiencies are remedied.**
- **Management completes a checklist as an attachment to their assertion letter.**
- **Ensure that source documentation is available for audit.**



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L3-24

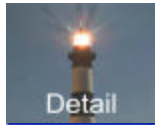
During the Discovery and Correction Phase, you identified deficiencies. In the Validation Phase, you validate the corrective actions identified in the discovery and correction phase. This is necessary to ensure that sufficient controls are in place to support management's assertion that the specific line or statement is ready for audit.

Each component of the Department implements Section 1008 and assesses the reliability of their financial statements. The review process is a responsibility of management and may be performed by management, internal auditors, or a contractor. This process is used in determining if a statement or line item is ready for audit by the DoDIG.

The Business Rules provide management with a checklist that is designed to assist components preparing for audits by providing the information that is typically needed for financial statement audits. This checklist may begin during the Discovery and Correction Phase to assist those performing the assessment in validating that these steps have been completed.

Let's look at one reconciliation tool, the validation checklist.





## How to Use Reconciliation Tools for Validation (cont.)



### Validation Phase Checklist

- **State how balances were derived on the statements.**
- **Collect supporting detail from feeder systems.**
- **Identify where evidential matter is located.**
- **Summarize validation work performed.**
- **Provide organization chart with key personnel.**
- **Identify if systems have been audited.**
- **Describe major hardware and software of systems, and copies of certifications and accreditations, systems locations, and systems users.**

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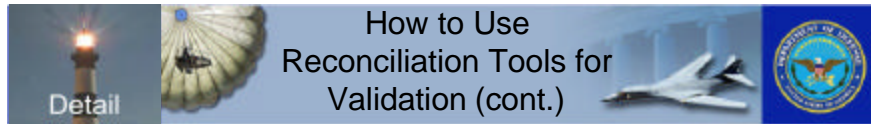
L3-25

The checklist is part of the Validation Phase and a requirement of the Business Rules. This checklist is used when performing corrective actions and while preparing the assertion package. It is important that specific items needed for the audit are identified by the auditors in the form of the Prepared by Client (PBC) list. The items on the Validation Phase checklist are not all inclusive, but identify some important areas for discussion and review.

Management identifies and documents procedures, processes, and control points for deriving balances being asserted. This includes the systems and the flow of data. For example, management could identify how data flows from the field level to the departmental level.

Management ensures that the total of the details equals the balance of the line item being asserted. For example, if the accounts payable control account equals \$100,000.00, you must determine that the subsidiary is the same amount. Management ensures that the validation work performed is summarized to establish audit readiness. Organization charts are compiled by management indicating key personnel along with their responsibilities and phone numbers.





CHECKLIST	
<p>When performing corrective action validation and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.</p> <p>This check list is designed to help components prepare for audits by providing the information that is typically needed for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditors in the form of a "Prepared By Client (PBC) List."</p> <p>The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in validating that these steps have been completed.</p> <p><input type="checkbox"/> 1 Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that make up the balance(s) being asserted as ready for audit.</p> <p><input type="checkbox"/> 2 Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.</p> <p><input type="checkbox"/> 3 Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expeditious retrieval.</p> <p><input type="checkbox"/> 4 Prepare a summary of the validation work performed by management Service auditors, internal auditors, or independent public accounting firms to establish audit readiness, if applicable.</p> <p><input type="checkbox"/> 5 Complete all the corrective actions in your Mid-Range Financial Improvement Plan for the material deficiencies related to the balance(s) being asserted.</p> <p><input type="checkbox"/> 6 Using the information from number 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.</p> <p><input type="checkbox"/> 7 Complete organization charts indicating key personnel and their responsibilities and phone lists.</p> <p>8 For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 7008 audit conducted on the systems?</p> <p><input type="checkbox"/> Yes. If yes, provide the date and point of contact.</p> <p><input type="checkbox"/> No.</p>	<p><input type="checkbox"/> 9 For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 7008 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10.</p> <p>If a FISCAM or SAS 7008 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the following information will have to be gathered prior to the audit for each system.</p> <p><input type="checkbox"/> 10 Prepare a description of the major hardware and software of the system and interfaces with other systems.</p> <p><input type="checkbox"/> 11 Describe what type of data the system produces for the financial statements, e.g. accounting transactions.</p> <p><input type="checkbox"/> 12 Prepare a description of telecommunications devices and networks used with the system.</p> <p><input type="checkbox"/> 13 Obtain a copy of the most recent certifications and accreditations of the system.</p> <p><input type="checkbox"/> 14 Identify the system location(s) and end user locations.</p> <p><input type="checkbox"/> 15 Identify the location(s) of system documentation.</p> <p><input type="checkbox"/> 16 Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.</p> <p><input type="checkbox"/> 17 Obtain a list of all system users - this should be a print out that shows the user and level of access.</p> <p><input type="checkbox"/> 18 Inquire if there are any ongoing or planned system reviews - if there are, determine when the reviews will be complete.</p>

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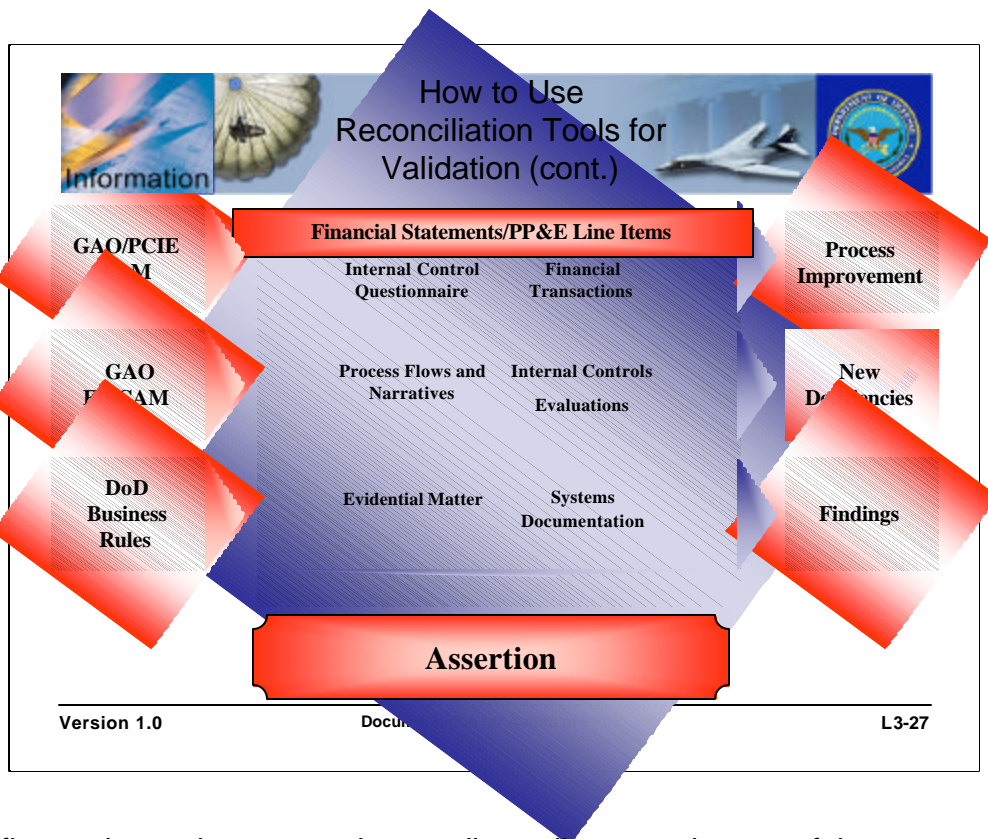
Documentation for Audits of PP&E

L3-26

This checklist, also found in Appendix C, is included in the Financial Improvement Initiative Business Rules Memo and is used when performing corrective action validation and while preparing the assertion package. It is designed to assist components prepare for audits by providing the information that is typically needed for financial statement audits.

Let's discuss the validation overview process.





This figure shows the approach to audit readiness and some of the reconciliation tools used to achieve assertion with the ultimate goal of an unqualified opinion.

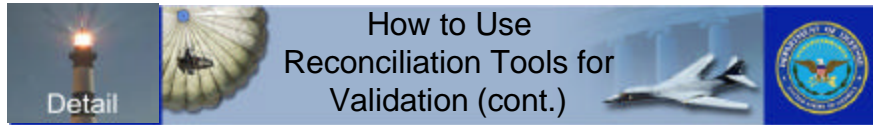
The figure has three columns. The first column shows the validation tools that we discussed in this lesson. The second column is the financial statement/line items. The last column provides information on process improvements, new deficiencies, or other findings. Starting with the business rules and other validation tools, you are developing an approach to validate audit readiness on selected financial statement line items and eventually to the assertion process.

The essence of the chart shows the tools used to affect the financial statements leading to iterations of improvements, findings, and changes that ultimately are reflected in management's assertion.

In the validation process, you document business events and processes (including systems) that affect the line items in the financial statements. You identify controls and assess risks. For the line items selected, you should be able to produce evidential matter to support the balances. During this validation process, you determine if the process is correct and if there is a basis for asserting readiness for audit.

Our ultimate goal is receive an unqualified opinion on your FY 2007 financial statements. Let's look at the assertion phase.

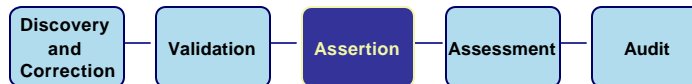




## Assertion Phase

### Assertion memorandum includes:

- **Assertion letter**
- **Summary of validation work and deficiencies resolution**
- **Reports from validation**
- **Completed checklist.**



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During the Assertion Phase, the entity prepares a Management Assertion Memorandum. It informs the DoDIG that the entity has completed corrective actions of the material deficiencies to the PP&E items on the balance sheet and is ready for audit.

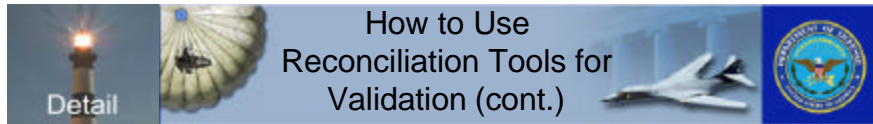
The entity notifies the DoDIG that their PP&E deficiencies were corrected during the Validation Phase and that a financial statement or line item is ready for audit. When the package is furnished to the DoDIG a copy is also furnished to the OUSD(C) point of contact who will forward it to the Review and Prioritization Committee (RPC). The assertion package contains:

- the management's assertion letter asserting audit readiness of the line or statement that has been validated
- a summary of the validation work performed and how the deficiencies were resolved by management
- the reports resulting from the validation and the checklist completed during the validation phase
- the completed checklist.

The DoDIG reviews the assertion package and determines whether it will conduct an assessment of the entity's PP&E line or statement, or bypass the Assessment Phase and proceed to the Audit Phase. It is the judgment of the DoDIG whether to assess or audit. The entity will be notified if it is approved for assessment or audit.

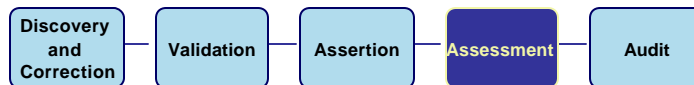
Let's discuss the Assessment Phase.





### Assessment Phase

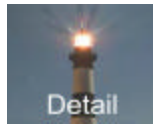
- **Assesses the reliability of assertions.**
- **Performed by DoDIG or contract auditors.**
- **DoDIG recommends when to audit.**



During the Assessment Phase, the DoDIG makes a determination regarding the reliability of the line or statement that the entity asserted as being ready for audit. This step is generally done if an entity has never been audited or if the DoDIG believes circumstances exist that would cause an entity to obtain an opinion other than unqualified. The DoDIG performs the assessment or contracts independent auditors for the task. The scope of the assessment is determined in accordance with the GAO FAM. During the Assessment Phase, the DoDIG determines whether the entity can achieve an unqualified opinion. Entity's audit committee and management review and monitor progress. Deficiencies are identified and corrected during the Assessment Phase. The DoDIG recommends when it is appropriate to move forward with an audit.

Let's discuss the Audit Phase.



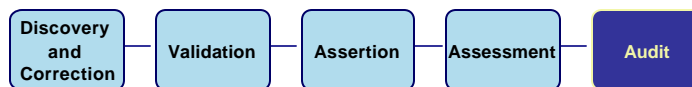


## How to Use Reconciliation Tools for Validation (cont.)



### Audit Phase

- **Ultimate Goal is an unqualified opinion.**
- **Entity's Accounting Records are reviewed.**
- **Engagement and Management Representation letters are prepared.**



The ultimate goal for your entity is an unqualified audit opinion on its financial statements and the auditor's opinion on the fairness of the presentation of the information on the financial statements. The DoDIG determines the appropriate scope and nature for financial audits and the associated reports.

Management representation letters are prepared including assertions to date. Any deficiencies are immediately addressed with a plan for resolution along with a resolution date.

If necessary, the DoDIG intervenes to end the audit and recommends a follow-up assessment if the audit may not have a favorable conclusion.

Let's summarize this lesson.





## Lesson Summary



- **Evidential matter requirements**
- **Five categories of assertions**
- **Reporting requirements for property in the possession of contractors**
- **Reconciliation tools for validation**
- **Five Phases of Financial Improvement Initiative Business Rules**

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During this lesson, we discussed key information that will assist you in obtaining a clean audit. We discussed evidential matter and its relevance to the specific audit objectives being tested. The guidance for maintaining these records is based on NARA, DoDFMR, and SFFAS. Audit trails were discussed and defined.

We discussed the five categories of assertions: existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure.

We discussed the requirements for contractors who acquire PP&E from a DoD component and some of the supporting documentation.

You learned the requirements in the FAR for the contractor's responsibility using, recording, reporting, segregating, and inventorying of government PP&E.

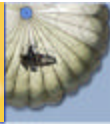
We discussed the requirements for annual financial statement and the applicable guidance. We talked about the composition of the statements and accounting principles for federal entities.

You learned audit readiness and the validation tools used by management leading to the assertion phase.

The five phases of the DoD business rules were discussed: Discovery and Correction, Validation, Assertion, Assessment, and Audit. These validation tools are important for management to use and should result in an unqualified audit opinion on your FY 2007 financial statements.

Let's look at some important websites.





## References



**DoDFMR:** <http://www.dod.mil/comptroller/fmr/>

**GPRA:**

<http://www.whitehouse.gov/omb/mgmtgpra/gplaw2m.html>

**OMB Circular A-123:**

<http://www.whitehouse.gov/omb/circulars/a123/a123.html>

**FMFIA:** <http://www.dod.mil/comptroller/fmfia>

**FAR:** <http://www.arnet.gov/far/>

**AICPA:** <http://www.aicpa.org/index.html>

These are web sites that can be used for references for the DoDFMR, GPRA, OMB Circulars, FMFIA, FAR, and the AICPA.





## References



**GAO/PCIE FAM:**

**<http://www.gao.gov/special.pubs/gaopcie/>**

**GAO Government Auditing Standards:**

**<http://www.gao.gov/govaud/ybk01.htm>**

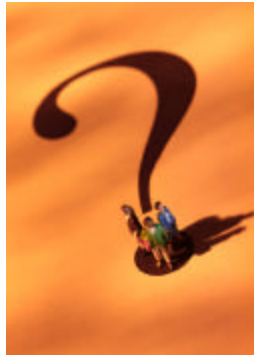
**OMB Bulletins 01-02 and 01-09:**

**<http://whitehouse.gov/omb/bulletins/>**

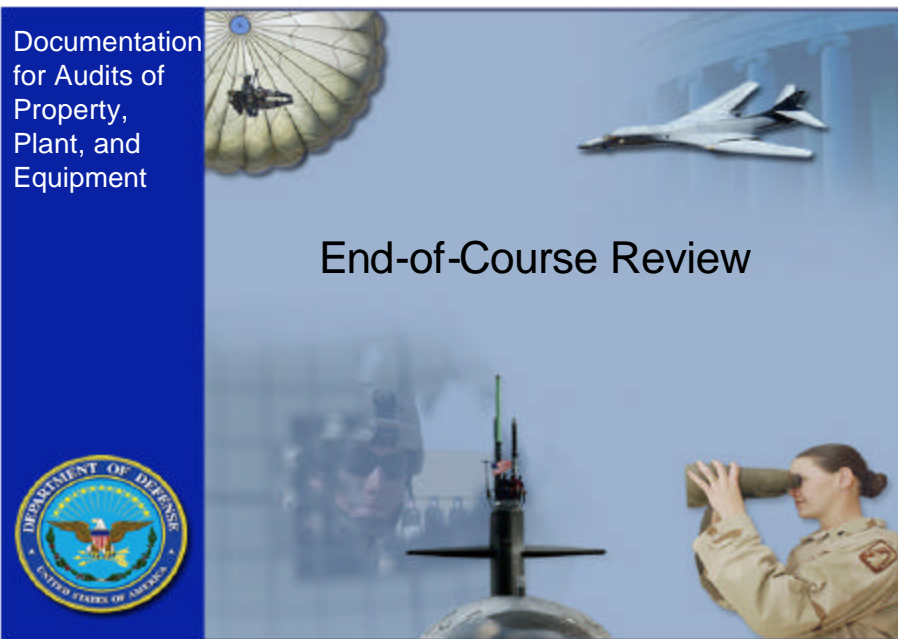
**FASAB: <http://www.fasab.gov/>**

These are web sites that can be used for references for the GAO/PCIE FAM, the GAO GAS, OMB Bulletins, and FASAB.







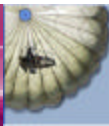


Let's review the course objectives that we discussed today in this course.

You should now be able to define requirements, regulations, statutes, and thresholds for each component for PP&E audits; document transactions for components of PP&E; and explain how to manage the evidential matter to support assertions.

Let's review identifying critical components of property; documenting transactions for components of PP&E; and managing evidential matter to support assertions.





## End-of-Course Review



### **Lesson 1, Identifying Critical Components of Property:**

- **FASAB Standards**
- **DoD financial management systems**
- **Preventing inconsistencies**
- **Legal issues**

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R-2

Lesson 1, Identifying Critical Components of Property, explained the FASAB standards including the SFFAS, which are designated to implement the GAAP. The SFFAS have a major role in fulfilling the government's duty to be publicly accountable. These standards add credibility to the department's annual audited financial statements.

We discussed the department's need to establish DoD financial systems that support full disclosure of federal financial data. Both the FFMIA and the PMA advance the need to conform to the USSGL and applicable federal accounting standards. Some of the DoD goals were discussed including the DoD Financial and Feeder Systems Compliance Process.

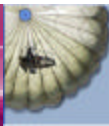
Several organizations leading the way to improve the Department's financial reporting systems were discussed. Among them were the BMMP and the BEA. We also discussed the JFMIP, which consists of members of the Treasury, GAO, OMB, and OPM.

In the overall process, preventing inconsistencies is a way to manage risk. Some areas relevant to documentation for audits of PP&E include inconsistencies that create material weaknesses. Maintaining proper source documentation is important when accounting for PP&E. We discussed the importance of cost and depreciation inconsistencies when accounting for General PP&E.

We discussed how Congress continually provided clarification to their intent through such laws as the FMFIA, CIOA, GPRA, and GMRA. These laws discussed the importance of accountability through systems, people, and practices.

Let's review other lesson topics.





## End-of-Course Review



### **Lesson 1, Identifying Critical Components of Property (cont.):**

- **Management responsibilities**
- **Audit coordination**
- **Audit trails**
- **Internal controls**

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R-3

Management responsibilities include the relationship between source documentation and the financial statements. Management must ensure that personnel are trained to understand the impact of their job on the mission of the Department. Additional responsibilities include being familiar with departmental and regulatory guidance such as the Financial Improvement Initiative Business Rules, GAO, PBC List, and the PMA.

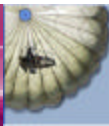
Audit coordination should be ongoing, not just a last-minute effort. We discussed the PBC List and talked about the need of making contacts both internally and externally to your organization.

The definition of an audit trail was provided. This is a trail of source documents through financial management systems and/or property management systems that eventually are reflected on your annual financial statements. We discussed supporting documentation and records retention requirements of the DoDFMR and NARA.

We discussed good internal controls within the Department. Congress and other regulatory agencies established guidance for the Department to follow.

Now let's review Lesson 2, Documenting Transactions for Components of PP&E.





## End-of-Course Review



### **Lesson 2, Documenting Transactions for Components Of PP&E:**

- **Land**
- **Buildings, Structures, and facilities**
- **Leasehold improvements**

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Documentation for Audits of PP&E

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Lesson 2, Documenting Transactions for Components of PP&E, explained the three categories of PP&E: General PP&E, Heritage Assets, and Stewardship Land. General PP&E consists of tangible assets that meet the following criteria: useful life of two or more years; not intended for sale; built or acquired to be used by an entity; and a market value that equals or exceeds the DoD capitalization threshold of \$100,000.00.

We discussed terms such as capitalization, preponderant use, capital improvements, and depreciation.

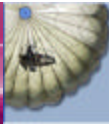
There are three categories of land: Stewardship Land, Land, and Land Rights. Stewardship Land is land provided to the DoD from public domain, or at no cost, not used in a General PP&E context. Land (other than Stewardship Land) has an identifiable cost and is specifically acquired for, or in connection with, the construction of PP&E. Land rights are interests and privileges held by the DoD, or Department component, in land owned by others.

Buildings, structures, and facilities are considered real property and are included in General PP&E. They are recorded in property management and financial management systems for reporting purposes.

General PP&E includes leasehold improvements. These are improvements to assets that were acquired through capital leases.

Let's review internal use software, general equipment, and military equipment.





## End-of-Course Review



### **Lesson 2, Documenting Transactions for Components of PP&E (cont):**

- **Internal use software**
- **General equipment**
- **Military equipment**

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Documentation for Audits of PP&E

R-5

We discussed the three categories of internal use software: COTS, software developed internally by the DoD, and software developed by a paid DoD contractor.

The category of general equipment was discussed along with the criteria for capitalization and depreciation. The equipment is recorded in a property management and financial management system for accounting and reporting purposes.

When the FASAB adopted SFFAS No. 23, the Department was required to value and capitalize military equipment such as aircraft, ships, and tanks. These items are reported on the DoD's financial statements.

Let's review assets under capital lease, CIP, and other General PP&E.





## End-of-Course Review



### **Lesson 2, Documenting Transactions for Components of PP&E (cont):**

- **Assets under capital lease**
- **Construction in progress**
- **Other general PP&E**
- **Documentation**

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Documentation for Audits of PP&E

R-6

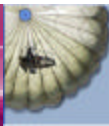
You learned that assets under capital lease are recorded in an account called Assets Under Capital Lease. There is specific guidance in the DoDFMR that transfers the benefits and risk of ownership to the lessee. If the leased asset equals or exceeds the DoD threshold for capitalization, it is depreciated and reported on the Department's financial statement.

We discussed the CIP account, which is used to accumulate costs of real property construction projects. The USACE or NAVFAC is responsible for providing this work. They are required to provide the appropriate reporting component with supporting documentation in sufficient detail to reconcile their CIP balances by project and funding source.

The account called Other General PP&E is used to account for property removed because of BRAC.

Now let's review Lesson 3, Managing Evidential Matter to Support Assertions.





## End-of-Course Review



### **Lesson 3, Managing Evidential Matter to Support Assertions:**

- **How to report government property in the possession of contractors**
- **How to use reconciliation tools for validation**

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Documentation for Audits of PP&E

R-7

Lesson 3, Managing Evidential Matter to Support Assertions, explained evidential matter when reporting government property in the possession of contractors. In addition, we discussed some different types of reconciliation tools used for validation. We discussed evidential matter and the different types of source documentation auditors look for during audits of financial statements. Specific guidance was discussed such as the DoDFMR, NARA, GAO, and DFAS publications.

Audits trails were discussed and their importance when auditors conduct an audit of your financial statements. We discussed legislative acts and other guidance such as the FMFIA, GPRA, and OMB Circulars. The five categories of assertions presented by management were discussed. The guidance for contractors that is contained in the DoDFMR and FAR were discussed. These publications provide guidance for contractors when they account for government property in their possession.

We looked at some of the different types of forms used to account for government property such as the DD Form 1662, Property in the Custody of Contractors. Some key reconciliation tools such as the OUSD(C) Business Rules, DoDFMR, GAO standards, and FASAB Concepts and Standards.

We learned that Note 10 is of particular interest for the accurate reporting of PP&E in the financial statements and should compare to Line 1F in the Balance Sheet. Our ultimate goal from applying what we learned in this course is an unqualified opinion on our annual financial statements.

Now that we finished the end-of-course review, it's time to explain the final examination.



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## Appendix A. Glossary

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This glossary should serve as a reference tool for DoD personnel who need an understanding of auditing terminology. It is not all-inclusive and reflects both acronyms and terms introduced throughout this course.

<b>Acquisition</b>	To come into possession or control, by purchase or other means, of a new or improved asset.
<b>AcSEC</b>	Accounting Standards Executive Committee (of the AICPA)
<b>ADP</b>	Automated Data Processing is the use of computer equipment to facilitate accounting, budgeting, and other processes.
<b>AICPA</b>	American Institute of Certified Public Accountants
<b>AIMD</b>	Accounting and Information Management (GAO)
<b>Allocation Assertion</b>	See valuation
<b>Amortization</b>	The periodic recognition of the consumption (expense) of an intangible asset
<b>AR</b>	Army Regulation
<b>Assertion</b>	Explicit and implicit information provided by management that attests to the represented financial position or results of operations
<b>Assertion Letter</b>	A representation by management that a financial statement or line item is ready for audit
<b>Asset</b>	The property owned by an entity. Assets are classified in several ways, including assets that are tangible and intangible. While tangible assets are more easily defined, intangible assets are those long-lived assets useful in the operation of entity that are not held for sale and have no physical qualities. Examples of intangible assets include patents, copyrights, franchises, trademarks, trade names, and goodwill.
<b>AT&amp;L</b>	Acquisition, Technology, and Logistics is an office located within the Office of the Secretary of Defense.
<b>Auditable</b>	The condition where underlying data and procedures are sufficient, accurate, testable, and reliable enough for an auditor to obtain a basis for forming an unqualified opinion
<b>Audit Ready</b>	The condition where underlying data is auditable and the staff is ready to support that data in an audit process



<b>Audit Risk</b>	A risk taken when an auditor unknowingly fails to modify his or her opinion appropriately on financial statements that are materially misstated
<b>Audit Trail</b>	A chain of evidence provided by coding, cross-references, and documentation connecting account balances and other summary results with original transaction data
<b>BEA</b>	Business Enterprise Architecture is a mechanism to better manage the Department's business operations and to structure the complex systems and organizational interrelationships.
<b>Benchmark</b>	A standard against which others are measured
<b>Best Practice</b>	A process or procedure that can be used as a good example for others in similar organizations
<b>BMMP</b>	The Business Management Modernization Program is a vehicle designed to transform business operations and improve oversight and accountability for the billions of dollars spent designing, building, operating, and maintaining business systems that support the Department's primary missions.
<b>BRAC</b>	The Congressional mandate to eliminate excess physical capacity, the operation, sustainment, and recapitalization of that which diverts scarce resources from Defense capability
<b>Capitalize</b>	To record and carry forward into one or more future periods any expenditure from which the benefits will then be realized
<b>CFO</b>	A Chief Financial Officer is an organization's senior financial executive.
<b>CFOA</b>	The Chief Financial Officers Act of 1990 is intended to improve financial management systems and information to produce timely, reliable, and comprehensive financial information.
<b>CFOC</b>	The Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies, senior officials of the Office of Management and Budget, and the Department of the Treasury, who work collaboratively to improve financial management in the U.S. government.
<b>CIP</b>	Construction in Progress
<b>Completeness Assertion</b>	An assertion about whether all transactions and accounts that should be presented in the financial statements are so included
<b>Compliance</b>	The conformity to the rule of law, standard practice, or specified procedure
<b>COTS</b>	Commercial Off-the-Shelf



<b>Cycle Memorandum</b>	A depiction in words and/or a diagram form of the activities relating to a particular type of transaction such as the revenue cycle, expenditure cycle, financing cycle, personnel services cycle, or production cycle
<b>DCAA</b>	The Defense Contract Audit Agency is responsible for performing all contract audits for the Department, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration.
<b>D.C.</b>	District of Columbia
<b>DD</b>	Department of Defense (Form)
<b>DeCA</b>	The Defense Commissary Agency intends to deliver the premier quality of life benefit to the armed services community to enhance recruiting, retention and readiness by efficiently and effectively providing exceptional savings and excellent products and services – every time, every place.
<b>Depreciation</b>	The allocation of the cost of an asset over a period of time for accounting and/or tax purposes; also, a decline in the value of property due to general wear and tear or obsolescence
<b>DFAR</b>	Defense Federal Acquisition Regulation
<b>DFAS</b>	The Defense Finance and Accounting Service has the mission to provide responsive, professional finance and accounting services for the people who defend America.
<b>Deficiency</b>	In an audit, the term deficiency describes a lack in adequate competence, readiness, knowledge, or means. It may be synonymous with fault.
<b>Disclosure</b>	Making something known to the public, as in disclosing the financial position of an entity through the publishing of its financial statements and accompanying notes
<b>DLA</b>	The Defense Logistics Agency provides worldwide logistics support for the missions of the military departments and the Unified Combatant Commands under conditions of peace and war. It also provides logistics support to other DoD components and certain federal agencies, foreign governments, international organizations, and others as authorized.
<b>DoD</b>	Department of Defense (also referred to as the Department)
<b>DoDFMR</b>	Department of Defense Financial Management Regulation (7000.14-R)
<b>DoDIG</b>	Department of Defense Inspector General
<b>DWCF</b>	Defense Working Capital Fund



<b>EDA</b>	Electronic Document Access
<b>ENG</b>	Engineer
<b>Engagement</b>	Describes the process of conducting an audit; the formal agreement to provide a service, as in an audit engagement letter or contract
<b>Entity</b>	An organization, unit, or body, such as a department, fund, agency, or section
<b>ESC</b>	Executive Steering Committee
<b>Evidential Matter</b>	Audit evidence that consists of underlying accounting data or financial records and all corroborating information available to an auditor
<b>Existence Assertion</b>	An assertion about whether assets or liabilities of an entity exist at a given date, and whether recorded transactions have occurred during a given period; also called existence occurrence
<b>Existence Occurrence</b>	See existence assertion.
<b>FAM</b>	The Financial Audit Manual is a manual established by the GAO and the PCIE to ensure that the financial statement audits have their intended outcome.
<b>FAR</b>	Federal Acquisition Regulation
<b>FASAB</b>	The Federal Accounting Standards Advisory Board has the mission to promulgate federal accounting standards after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.
<b>FASB</b>	Financial Accounting Standards Board
<b>FFMIA</b>	The Federal Financial Management Improvement Act builds on the CFO Act by emphasizing the need for agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions and to ensure accountability on an ongoing basis.
<b>FII</b>	The Financial Improvement Initiative promotes the achievement of an unqualified opinion on the Department's consolidated financial statements by FY07.
<b>FISCAM</b>	Federal Information System Controls Audit Manual



<b>FMFIA</b>	The Federal Manager's Financial Integrity Act requires federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. It further requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities.
<b>FMMP</b>	The Financial Management Modernization Program was renamed the BMMP on May 20, 2003.
<b>FMR</b>	Financial Management Regulation (see DoDFMR)
<b>FMS</b>	The Foreign Military Sales program manages government-to-government purchases of weapons and other defense articles, defense services, and military training.
<b>FUDS</b>	Formally Used Defense Sites is a type or classification of site, comparable to DoD installation or BRAC site.
<b>FY</b>	Fiscal Year
<b>GAAP</b>	General accepted accounting principles are the common set of accounting principles, standards, and procedures. GAAP is a combination of authoritative standards (set by policy boards) and the accepted ways of doing accounting.
<b>GAGAS</b>	Generally Accepted Government Auditing Standards
<b>GAO</b>	The Government Accountability Office, previously called the General Accounting Office, is an independent, nonpartisan agency that works for Congress. The GAO is often called the "congressional watchdog" because it investigates how the federal government spends taxpayers' dollars.
<b>GMRA</b>	The Government Management Reform Act of 1994 updated the CFOA by setting standards for the effectiveness of financial management reporting.
<b>GPRA</b>	The Government Performance and Results Act of 1993 aims to improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction.
<b>GRS</b>	The General Records Schedule is issued by the Archivist of the United States to provide disposition authorization for records common to several or all agencies of the federal government.
<b>GS</b>	General Schedule
<b>GSA</b>	General Services Agency



<b>IAW</b>	In accordance with
<b>IBM</b>	International Business Machines
<b>ID</b>	Identification
<b>IG</b>	The Inspector General has traditionally served as “an extension of the eyes, ears, and conscience of the Commander.” Pursuant to the Inspector General Act of 1978, as amended, “the Inspector General of the Department of Defense shall . . . be the principal adviser to the Secretary of Defense for matters relating to the prevention of fraud, waste, and abuse in the programs and operations of the Department.”
<b>IGT</b>	Intergovernmental Transaction
<b>IMPAC</b>	International Merchant Purchase Authorization Card
<b>IPA</b>	Independent Public Accountant
<b>Internal Controls</b>	Refers to processes that are designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, compliance with applicable laws and regulations, and the effectiveness and efficiency of operations
<b>Internal Review</b>	An inspection of processes and data of an entity by personnel employed by or internal to the entity
<b>JFMIP</b>	The Joint Financial Management Improvement Program is a joint and cooperative undertaking of the Department of the Treasury, the GAO, the OMB, and the OPM working in cooperation with each other and other agencies to improve financial management practices in government.
<b>Liability</b>	A legal responsibility or accountability for an amount owed
<b>Materiality</b>	In an audit, materiality refers to the degree of importance or consequence.
<b>MC</b>	Management Control (see also MCP)
<b>MCP</b>	A management control program provides reasonable assurance that obligations and costs comply with applicable laws and emphasizes prevention of waste, fraud, mismanagement, and timely corrections of MC weaknesses.
<b>MDA</b>	The Management Discussion and Analysis section, found on financial statements, allows management to discuss aspects of an entity’s financial statement that may be otherwise difficult to locate. It provides a summary and more.



<b>MIPR</b>	Military Interdepartmental Purchase Request
<b>N/A</b>	Not available
<b>NARA</b>	The National Archives and Records Administration ensures for the citizens and the public servant, for the President, Congress, and Courts, ready access to essential evidence.
<b>NDPP&amp;E</b>	The National Defense PP&E was previously expensed in the period incurred, but all are now classified as general PP&E and capitalized, with the exception of the cost of land and land improvements that produce permanent benefits, which are depreciated.
<b>No.</b>	Number
<b>Non-statistical Sampling</b>	A group of methods used in audits to determine the size of a sample to be tested and the evaluation of the results that is less objective and more subjective and judgmental than the statistical sampling approach
<b>NRV</b>	Net Realizable Value is a valuation method.
<b>O&amp;M</b>	Operations and Maintenance
<b>OFFM</b>	The Office of Federal Financial Management was created within the OMB by the CFOA of 1990. The OFFM is responsible for the financial management policy of the federal government including implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFOA.
<b>OIG</b>	Office of Inspector General
<b>OMB</b>	The Office of Management and Budget has a mission to assist the President in overseeing the preparation of the federal budget and to supervise its administration in Executive Branch agencies.
<b>OM&amp;S</b>	Operating Material and Supplies
<b>OPM</b>	The Office of Personnel Management is the federal government's human resource agency.
<b>OUSD(C)</b>	Office of the Under Secretary of Defense (Comptroller)
<b>OUSD(HA)</b>	Office of the Under Secretary of Defense (Health Affairs)
<b>P&amp;EP</b>	Property and Equipment Policy
<b>PARS</b>	Performance and Accountability Reports



<b>PBC</b>	A Prepared by Client list is a list that facilitates the audit process by coordination with specific points-of-contact.
<b>PCIE</b>	The President's Council on Integrity and Efficiency was established to address integrity, economy, and effectiveness issues that transcend individual government agencies, and increase the professionalism and effectiveness of IG personnel throughout the government.
<b>P&amp;EP</b>	Property and Equipment Policies
<b>PMA</b>	The President's Management Agenda is an aggressive strategy for improving the management of the federal government. It focuses on five areas of management weaknesses across the government where improvements and the most progress can be made.
<b>PMO</b>	Program Management Office
<b>POC</b>	Point of Contact
<b>Population</b>	In an audit, a population is a class of transactions or the account balance to be tested.
<b>PP&amp;E</b>	Property, Plant, and Equipment
<b>Qualified Opinion</b>	An auditor's opinion stating that except for the effects of the matter(s) to which the qualification relates, the financial statements present the position of the organization fairly.
<b>Readiness</b>	See audit ready.
<b>Reasonable Assurance</b>	Assurance that a reasonable person can reach the same conclusion given the same data and circumstances; not an absolute certainty
<b>RFA</b>	Ready for Audit
<b>Rights and Obligations Assertion</b>	An assertion about whether assets are the rights of the entity, and liabilities are the obligations for the entity, at a given date
<b>Risk Adverse</b>	A condition in which an auditor is not willing to accept a moderate or high level of audit risk, usually when the client has a greater likelihood of financial failure or there are many users of the statements and audit reports
<b>RPC</b>	Review and Prioritization Committee
<b>RPS</b>	Review and Prioritization Sub-committee



<b>Sample</b>	In an audit, a sample is a single unit within a class of transactions or account balances to be tested.
<b>SAS</b>	Statements of Accounting Standards
<b>SEC</b>	Securities and Exchange Commission
<b>SECDEF</b>	Secretary of Defense
<b>SFFAC</b>	Statement of Federal Financial Accounting Concepts
<b>SFFAS</b>	Statement of Federal Financial Accounting Standards is the standards issued by the FASAB to implement the GAAP for the federal government.
<b>SOP</b>	Standard Operating Procedure
<b>Source Documentation</b>	Documents representing authorization for original transactions and associated with transaction data. These documents include contracts, invoices, funding authorizations, bills of lading, receiving reports, titles, mortgages or notes, leases, agreements, appointments, signature cards, policies, and others.
<b>Statistical Sampling</b>	A mathematical method or combination of methods used to determine the number of items in a population to examine
<b>Systemic</b>	Describes a problem involving one or more financial reporting systems that results in an inability to provide accurate, reliable, or timely financial data
<b>TDY</b>	Temporary Duty
<b>TFM</b>	Treasury Financial Manual
<b>TI</b>	Treasury Index is the Treasury's code for the various funds used in the federal government. Examples in DoD include TI 97, 57, 21, and 17.
<b>Unqualified Opinion</b>	An auditor's opinion that is without any material exception as to a general statement of reliability of the items specified within the limits of an audit
<b>U.S.</b>	United States
<b>USD</b>	Under Secretary of Defense
<b>USD(C)</b>	Under Secretary of Defense, Comptroller
<b>USSGL</b>	United States Standard General Ledger provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.



<b>USTRANSCOM</b>	The United States Transportation Command is a unified command composed of elements from each of the services to provide air, land, and sea transportation for the DoD.
<b>Validation</b>	The corroboration, substantiation, or confirmation of relevant or meaningful information, supported by objective truth or generally accepted authority
<b>WCF</b>	The Working Capital Fund was established to be self-sustaining where products or services are produced and sold to recover the full cost of operations.

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## Appendix B. DoD Performance and Accountability Report Excerpt

The following is a sample of Note 10, General PP&E, Net.

<b>Note 10. General PP&amp;E, Net</b>						
As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
<b>1. Major Asset Classes:</b>						
A. Land	N/A	N/A	\$ 10,103.0	N/A	\$ 10,103.0	\$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	\$ (91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term 2-5 Or 10	139.1	(96.3)	42.8	96.2
D. Software	S/L	10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease <sup>1</sup>	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in-Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			\$ 1,388,610.3	\$ (947,711.7)	\$ 440,898.6	\$ 446,308.9
<sup>1</sup> See Note 15 on Capital Lease Liability for additional information						
Legend for Valuation Methods:						
S/L = Straight Line      N/A = Not Applicable						

### Fluctuations

General Property, Plant and Equipment (PP&E) decreased \$5.4 billion (1 percent). The significant changes are summarized below:

Buildings, Structures and Facilities decreased 8.4 billion (11 percent). The majority of this decrease was the result of an error in Navy General Fund data captured for FY 2003 accumulated depreciation. This error was corrected in FY 2004.

Leasehold Improvements reflected a net decrease of \$53.4 million (56 percent). The decrease is primarily attributable to the DFAS Working Capital Fund's one-time reclassification of \$48.3 million from Buildings, Structures and Facilities to Leasehold Improvements in FY 2003.



In FY 2004, the Department elected to display Military Equipment and General Equipment on separate lines for reporting purposes. The breakdown of the FY 2003 balance is a net book value of \$13 billion for General Equipment and \$325.1 billion for Military Equipment, therefore the true increase in General Equipment is \$3 billion. This increase is the result of the procurement of new equipment and better recognition of existing equipment.

### Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in millions)		
<b>1. Entity as Lessee, Assets Under Capital Lease:</b>		
A. Land and Buildings	\$ 574.6	\$ 574.6
B. Equipment	11.3	2.6
C. Accumulated Amortization	(379.2)	(343.6)
D. Total Capital Leases	<u>\$ 206.7</u>	<u>\$ 233.6</u>

Assets Under Capital Lease consist primarily of leases for the Section 801 Family Housing Program.

#### Fluctuations

Assets Under Capital Lease decreased \$26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

#### Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.



## Appendix C. Financial Improvement Initiative Checklist

The following is a checklist included in the Financial Improvement Initiative Business Rules Memo.

CHECKLIST	
<p>When performing corrective action validation and while preparing the assertion package, please complete the following checklist. Include the completed checklist as an attachment to your assertion letter.</p>	
<p>This check list is designed to help components prepare for audits by providing the information that is typically needed for financial statement audits. Keep in mind that the list of specific items you will need for an assessment or audit will come from the auditors in the form of a "Prepared By Client (PBC) List."</p>	
<p>The following steps may begin during the Discovery Phase or Correction Phase to assist those performing the assessment in validating that these steps have been completed.</p>	
<input type="checkbox"/>	1 Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that makes up the balance(s) being asserted as ready for audit.
<input type="checkbox"/>	2 Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.
<input type="checkbox"/>	3 Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expedient retrieval.
<input type="checkbox"/>	4 Prepare a summary of the validation work performed by management Service auditors, internal auditors, or independent public accounting firms to establish audit readiness, if applicable.
<input type="checkbox"/>	5 Complete all the corrective actions in your Mid-Range Financial Improvement Plan for the material deficiencies related to the balance(s) being asserted.
<input type="checkbox"/>	6 Using the information from number 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.
<input type="checkbox"/>	7 Compile organization charts indicating key personnel and their responsibilities and phone lists.
<input type="checkbox"/>	8 For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 70/88 audit conducted on the systems?
<input type="checkbox"/>	Yes If yes, provide the date and point of contact.
<input type="checkbox"/>	No



- ☐ 9 For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10.

**If a FISCAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the following information will have to be gathered prior to the audit for each system.**

- ☐ 10 Prepare a description of the major hardware and software of the system and interfaces with other systems
- ☐ 11 Describe what type of data the system produces for the financial statements, e.g. accounting transactions
- ☐ 12 Prepare a description of telecommunications devices and networks used with the system.
- ☐ 13 Obtain a copy of the most recent certifications and accreditations of the system.
- ☐ 14 Identify the system location(s) and end user locations.
- ☐ 15 Identify the location(s) of system documentation.
- ☐ 16 Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.
- ☐ 17 Obtain a list of all system users - this should be a print out that shows the user and level of access.
- ☐ 18 Inquire if there are any ongoing or planned system reviews - if there are, determine when the reviews will be complete.



# **Office of the Under Secretary of Defense (Comptroller) (OUSD(C))**

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## **Documentation for Audits of Property, Plant, and Equipment**

### **Final Examination**

**Student Name:** \_\_\_\_\_



Prepared by:  
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## Final Examination

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**Directions** This is an open-book final examination covering subject matter taught in this course. It will assess your knowledge of the general subject matter and requirements for documentation needed for audits of property, plant, and equipment. The final examination consists of questions that are multiple choice and fill in the blank. Write in or circle the correct answer to the questions.

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**Time Allocation** The time allocated to this examination is 40 minutes: 30 minutes for the exercise and 10 minutes for the critique.

Number	Question
1	Multi-use heritage assets should be _____. a. expensed and maintained off the Balance Sheet b. capitalized and depreciated over their service life c. tracked with other stewardship information only d. divided between official and non-official use and expensed accordingly
2	Property in possession of contractors _____. a. regardless of value, must be accounted for on property records b. should be capitalized, if it meets the threshold c. both a and b d. neither a nor b



Number	Question
3	<p>Which of the following is true about preponderant use?</p> <ul style="list-style-type: none"> <li>a. When a WCF activity is a preponderant user of a facility, they report and depreciate it.</li> <li>b. Regarding military medical treatment facilities, the military installation is considered the preponderant user, but the OUSD(HA) reports and depreciates it.</li> <li>c. When a WCF activity is not a preponderant user, but makes a capital improvement, the preponderant user will report and depreciate it.</li> <li>d. All of the above</li> </ul>
4	<p>An audit trail enables the _____ or _____ of a transaction from its source to the resulting record or report, and from the resulting record or report to the source.</p>
5	<p>Management control weaknesses should be _____.</p> <ul style="list-style-type: none"> <li>a. identified</li> <li>b. reported</li> <li>c. corrected</li> <li>d. All of the above</li> </ul>
6	<p>What is the DoD capitalization threshold?</p> <ul style="list-style-type: none"> <li>a. \$10,000.00</li> <li>b. \$100,000.00</li> <li>c. \$50,000.00</li> <li>d. \$500,000.00</li> </ul>
7	<p>List the three categories of PP&amp;E.</p> <p>_____</p> <p>_____</p> <p>_____</p>



Number	Question
8	<p>What is the name of the account used to accumulate costs of real property construction projects?</p> <ul style="list-style-type: none"><li>a. Capital Improvements</li><li>b. Construction in Progress (CIP)</li><li>c. Buildings, Improvements, and Renovations</li><li>d. Other General PP&amp;E</li></ul>
9	<p>What government entity is responsible for providing guidance for retention of financial records?</p> <ul style="list-style-type: none"><li>a. Office of Management and Budget</li><li>b. National Archives and Records Administration</li><li>c. General Accountability Office</li><li>d. Department of Defense</li></ul>
10	<p>What are some of the legislative acts/criteria for establishing audit trails?</p> <ul style="list-style-type: none"><li>a. Federal Managers Financial Integrity Act of 1982</li><li>b. Government Performance and Results Act of 1993</li><li>c. DoDFMR, Volume 1, Chapter 3, Key Accounting Requirements No. 8, Audit Trails</li><li>d. All of the above</li></ul>



Number	Question
11	<p>List the five broad categories of assertions.</p> <hr/> <hr/> <hr/> <hr/> <hr/>
12	<p>What type of opinion is an entity looking for when financial statements are audited?</p> <p>a. Disclaimer</p> <p>b. Unqualified</p> <p>c. Qualified</p> <p>d. Auditable</p>
13	<p>Evidential matter consists of _____ and _____ representing original source documentation.</p> <p>a. regulations, forms</p> <p>b. hardcopy, electronic copies</p> <p>c. forms, records of a documentary nature</p> <p>d. legislation, forms</p>
14	<p>List four key reasons for maintaining evidential matter.</p> <hr/> <hr/> <hr/> <hr/>